THE MEXICO ECONOMIC SUPPORT PROGRAM

104
Y 4. IN 8/16: M 57/5

The Mexico Economic Support Program...

HEARING

BEFORE THE

COMMITTEE ON INTERNATIONAL RELATIONS HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

MARCH 7, 1995

Printed for the use of the Committee on International Relations

SEP 12 1995

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THE MEXICO ECONOMIC SUPPORT PROGRAM

TUESDAY, MARCH 7, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON INTERNATIONAL RELATIONS,
Washington, DC.

The committee met, pursuant to notice, at 10:06 a.m. in room 2172, Rayburn House Office Building, the Hon. Benjamin A. Gilman (chairman of the committee) presiding.

Chairman GILMAN. The committee will come to order. I would like to call to order this hearing on the Mexican Economic Support Program. As my colleagues are well aware, administration witnesses did not appear before our committee at our hearing on February 1, the day after the administration announced its intention to provide a financial assistance package to Mexico through the Treasury's Exchange Stabilization Fund.

At that hearing and in subsequent hearings conducted under the able leadership of subcommittee Chairmen Toby Roth and Dan Burton, numerous foreign policy experts and economists presented differing opinion on the Mexican economic crisis and the policy we should adopt to meet that crisis.

That debate continued last week on the House floor during consideration of a resolution of inquiry by the gentlelady from Ohio, Marcy Kaptur, who will be joining us this morning, designed to provide information to the Congress to assure that Mexico has taken the necessary steps to strengthen its economy.

Our hearing today will also put on the public record the policies adopted by this administration to support political as well as economic reform efforts in Mexico.

We have with us today two very able administration officials, Under Secretary of the Treasury Lawrence Summers and Under Secretary of State for Political Affairs, Peter Tarnoff. They played key roles in devising this economic package and we look forward to hearing their testimony.

And in their statements, I would hope our witnesses will resist the temptation to paint all the critics of the current economic program with the same brush.

I believe one can be critical without necessarily seeking to overturn the entire agreement. While I do not plan to support an effort to stop the Treasury Secretary from using the Exchange Stabilization Fund to assist Mexico, I am determined that U.S. taxpayer funds be used wisely, efficiently, cost effectively, and that Mexico clearly demonstrate that it is undertaking the kind of policies that our Nation should support.

The administration mistakenly oversold NAFTA during the debate in Congress on that agreement, and I would hope that such an error would not be repeated with this economic plan.

Many of the extravagant expectations that were raised by the administration during the NAFTA debate proved to be promises that could not be kept.

When Mexican politicians used billions of pesos to protect unsustainable economic policies, we need to ask some very tough questions as to whether our taxpayer funds would also be used to support those same unsustainable policies.

In his speech before the Brookings Institution on March 3, Under Secretary Summers seemed to imply that critics of the economic plan were seeking to curtail our participation in the international financial institutions and in the United Nations.

Such thinly veiled partisan rhetoric certainly has no place in our debate. Any attempt to stifle criticism in this manner and to reply to the kind of rhetoric the administration used during the debate on the National Security Revitalization Act will certainly not help to resolve this difficult issue.

What is needed is a frank and honest appraisal of the current situation in Mexico, how long it is going take to restore economic stability, and how much it will cost our Nation in lost exports and increased immigration from Mexico to our own nation.

And finally, this administration needs to explain to us why it has put in place an economic rescue package for Mexico without first insisting that that country start implementing its own stabilization plan.

President Zedillo has stated that he has not yet implemented policies to reduce unemployment and inflation. And in that regard, it is clear that the economic pact agreed to by the ruling party, by business, and labor is a dead letter, and has not yet been replaced by a new agreement involving all segments of Mexican society.

We look forward to hearing our witnesses both on the substance of the economic plan and its implementation for a country whose economic policies and priorities are still uncertain.

I am pleased to call on our ranking minority member, Mr. Hamilton, for any opening remarks.

Mr. HAMILTON. Mr. Chairman, I commend you for these hearings. They are timely and we are delighted to welcome our two witnesses before the committee this morning.

I just want to say a word about how I think we got where we are on Mexico, and not so much the role of the administration, but the role of the Congress.

I think that the President's actions on Mexico were lawful, but like many of my colleagues, I am not comfortable with the idea that the President can loan a sum as large as $20 billion without an appropriation, and I certainly agree with my colleagues, as they have said and will say this morning, that we need more accountability and oversight over the Exchange Stabilization Fund.

But I think, to be quite fair, the Congress shares some of the responsibility for the course of action chosen by the President. The President, as I understand it, made a judgment in January that Mexico was on the brink of default, and that a default would harm U.S. national interests.

I also understand that the bipartisan leadership of the Congress backed the President's original loan guarantee request. It may have been that the President was slow off the mark in spelling out his case for the guarantees, and I think it is also correct that the congressional leadership, for whatever reasons, did not press hard for approval of the President's request.

I know that the administration worked very hard, and Mr. Summers led that effort to draft—to work with the Congress to draft a bill that addressed the concerns of a wide range of members.

Congress could not come to a closure on an acceptable bill, and as one of the Democrats involved in that process, I have to take some responsibility for that. When we were unable to come to closure when it became clear that legislation would not come before the Congress for a vote, or if it did, it would be defeated, the President struck out on his own.

At that point, I think, the President faced this choice. He could do nothing which he believed would have very damaging consequences for the United States, or he could act under executive authority.

And so we end up with a rescue plan that relies on direct U.S. Government loans rather than guarantees of private loans. We end up with a plan that includes none of the political or foreign policy objectives supported by a broad range of Members of this Congress, and we end up with a plan that provides for much less congressional accountability than the original guarantee proposal.

I do not think anybody is very happy with that outcome, nor should they be, but at least, in my judgment, this is outcome when the Congress does not step up to the plate and act on the tough questions that are put before it.

And I do not think it is correct for Members of Congress to blame only the President here for where we are because we share our full part of the responsibility.

Chairman GILMAN. Thank you, Mr. Hamilton. Mr. Gejdenson.

Mr. GEJDENSON. Thank you, Mr. Chairman. I just have two things that I hope our witnesses can cover in their testimony.

One is along with Chairman Hamilton, I would be curious as to the reactions that the administration received from the Speaker of the House regarding this proposal, and from the majority leader of the Senate, as well as obviously the minority leaders on both sides.

To get a sense of that dialogue I think would be important for members of this committee.

Additionally one of the things that I think has been missing in the debate about Mexico and for some time, even before the NAFTA debate, and while oftentimes reform seems to mean economic tightening of belts and reform of financial institutions, it seems the most fundamental reform that is necessary in Mexico is a better distribution of wealth; that one of the reasons that following World War II the countries of Western Europe succeeded when others did not is that they had a democratic distribution of wealth.

When the society's standard of living improved, there was a general improvement across the board, and having spent a considerable amount of private time in Mexico, one of the things that you come away with, and frankly I came away stunned by, was the disparity that exists, and the inability of the people at the bottom of

the economic ladder to make any progress in their own lives and their own economic situation.

I would hope that the witnesses would enlighten us as to the efforts the administration has made in trying to get across to the Mexicans, if it is the administration's position, that economic reform also has to mean that people at the bottom of the economic ladder have a chance to move upward, have a chance to organize, have a chance to get some benefits from improvements of society.

My feeling is without that, the Mexican economy will never be able to succeed.

Thank you, Mr. Chairman.

Chairman GILMAN. Mr. Rohrabacher.

Mr. ROHRABACHER. I hate to disagree with my colleague, Mr. Gejdenson, but I have lived in Mexico, and Mexico was developing, was in the midst of developing a strong middle class. The people of Mexico, by and large, are honest, hard-working people. Mexico itself is a land with great mineral resources and large territory, great beaches and great land, agricultural land.

What is lacking in Mexico is not a middle class and not upward mobility, what is lacking in Mexico is honest government and honest leadership.

I am extremely upset, along with other Members of Congress, that what it appears is that congressional authority has been circumvented in order to send tens of billions of dollars basically to a corrupt Mexican elite, and to Wall Street speculators.

This, at a time when we are struggling to try to come up with ways of bringing down the budget deficit, cutting programs for our own people, and then you have the President of the United States, with acquiescence of some leaders here on the Hill, transferring tens of billions of dollars to again a corrupt Mexican elite and Wall Street speculators. This is absolutely a disgrace and this Congress better deal with this or we are going to lose the faith of the American people.

The Mexican people lost faith with their government a long time ago because of shenanigans just like this. Here we see a fund that was meant to protect the stability of our currency being used to protect an irresponsible and corrupt elite in Mexico. That is absolutely insane, and basically gentlemen, I am anxious, and I will just leave it with this, I am very anxious to hear your testimony because I read things in the paper. I do not know if I brought this article with me today, but it appears that the currency speculators, the vultures of the world are beginning to circle around the U.S. currency because they seem to sense that our currency is vulnerable.

I want to know whether our stabilization fund is being drained, and whether the U.S. currency is put in jeopardy because that is the way it looks, just to pay off some of these people who decided to invest in Mexico rather than invest in the United States because there was a higher rate of return down there, and then they come back to the American people and expect us to save their investment.

I think it is ridiculous. I am angry about it. The American people are angry about it, and I am looking forward to the testimony.

Chairman GILMAN. Thank you, Mr. Rohrabacher. Mr. Lantos.

Mr. LANTOS. Thank you very much, Mr. Chairman. It comes as no surprise to anybody that I am here this morning as a very, very strong critic of the policy with respect to Mexico.

But in all fairness, a few things need to be stated, and need to be stated loud and clear. First, Mr. Chairman, I will ask unanimous consent that an article from today's *Washington Post* by the distinguished chairman of the Banking Committee, Jim Leach of Iowa, be part of this record.

Chairman GILMAN. Without objection.

[The attachment to Mr. Lantos' statement appears in the appendix.]

Mr. LANTOS. Because with his customary integrity, he sets straight the record on the pernicious and underhanded attacks on the integrity of the Secretary of the Treasury. Those attacks are sickening. They are reminiscent of the McCarthy era. They have no place in the 104th Congress, and we will see to it that they will get no respect and recognition in the 104th Congress.

Let me also say at the outset that I welcome the two very distinguished witnesses who have devoted years of most distinguished public service to our Nation, and who are here today, in my judgment, defending an indefensible policy, but I think it is important for us to recognize that their service to this nation has been great, and only those of us who have never made a mistake can castigate them with impunity.

Chairman GILMAN. Thank you, Mr. Lantos.

Mr. LANTOS. If you will allow me, Mr. Chairman, when Mr. Hamilton was chairman, he allowed you as a member of the minority to make an opening statement, and not be cutoff.

Chairman GILMAN. Yes, I thought that you had finished.

Mr. LANTOS. I just took a breath. [Laughter.]

The chairman will know when I am finished. There has never been a more bipartisan foreign policy mistake than our policy with respect to Mexico in recent years.

And while I take second place to no one in criticizing the policy, I think it is extremely important to recognize for our Republican friends that they led the parade in approving a fundamentally flawed policy in NAFTA. There is no way to integrate two societies as disparate in economic, social and political development as are Mexico and the United States.

And when the President made his proposal for the bailout, Bob Dole and Newt Gingrich were the principal cheerleaders. So let us get the record straight. If there is a mea culpa to be said, it is to be said by the Republican leadership of this body in both Houses, and by the administration.

And those of us who fought NAFTA, who felt that it was a policy that would lead to this disastrous result, the phony pumping up of the Mexican economy, the phony imports of vast quantities of American products for a moment of history that preceded the clearly predictable devaluation of the peso, and now the bailing out of Wall Street speculators and the Mexican elite, we are witnessing all this with turning stomachs.

I would also like to say, Mr. Chairman, that the people of this important neighboring country surely deserve better—they are honest, they are hardworking, they are decent, and they have had

the most rotten political leadership that we have seen in this hemisphere for a long time.

The recent episodes of the assassination of Presidential candidates, the alleged involvement of the President's brother, the hunger strikes, the outrageous suppression of human rights, civil rights, child labor rights in Mexico, have all been swept under the rug by the Republican sponsors of NAFTA, and by the administration.

And if it were not so tragic, we could be watching the unfolding of a comic opera.

Finally, Mr. Chairman, let me just say anybody who truly believes that if Mexico's economic conditions will worsen, as they obviously will, and they will not be able to meet their payments, and at that moment, this country will seize their oil revenues, is really smoking something mighty potent, because if Mexico should be on the verge of collapse, the last thing this government will do is to seize the remaining hard currency income of that government to bring about total chaos and collapse.

I think we are witnessing one of the great historic debacles in this hemisphere brought on by bipartisan stupidity and misjudgment, and the clean-up better be on a bipartisan basis.

Thank you, Mr. Chairman.

Chairman GILMAN. Thank you, Mr. Lantos. Mr. Burton.

Mr. BURTON. Thank you, Mr. Chairman. Mr. Summers, it is nice to know that you exist. You were to appear before my subcommittee a couple of weeks ago, but something unfortunate happened at the last minute and it was very regretful that you could not be there. However, we are glad to see you here today.

I am very disturbed because unilateral action is being taken by the administration in many areas where heretofore there was a partnership between the Congress and the executive branch.

When the problems in Haiti arose, the overwhelming majority of the American people did not want us to spend a billion and a half dollars to go in there. Many people still believe, myself included, that this may be an exercise in long-term futility and may cost the taxpayers billions of dollars without any good results.

We just left Somalia. We spent $2 billion, lost a lot of young peoples' lives, and we are right back where we started. The warlords are in charge. We did not gain a thing. We blew a lot of American taxpayers' money and nothing happens. Nothing changes.

Now, the response to Mexico is similar to the response to Haiti. The President acted unilaterally without any support from the Congress or the American people. Concerning Mexico, there were a number of us who were asked to participate in drafting legislation and would help deal with the problem.

Because we put some conditions on the loan guarantee, such as requiring Mexico to put some hard securities into American banks as collateral before receiving the loan to protect American taxpayers; because we wanted to have a more resolute attitude by Mexico on illegal aliens coming into this country; because we wanted Mexico and their leaders not to give direct or indirect assistance to Fidel Castro's Cuba; and because we wanted Mexicans in American prisons to be sent back for execution of sentence; the whole

proposal was junked. Those conditions were not acceptable politically to the Mexican Government.

We worked very hard to try to come up with a proposal that would work and would protect the American taxpayers as well as help Mexico.

Secretary Rubin and the President took unilateral action, once again, without any support from Congress; and are sending billions of American taxpayers' dollars down to Mexico.

In Vietnam we had unilateral action by the administration to normalize relations, even though 2,000-plus U.S. American servicemen are still unaccounted for.

Now we read this morning in the paper that there are going to be moves by the administration to normalize relations with the communistic dictatorship in Cuba, 90 miles from our shores, when there has been an embargo going on for a long time.

There has been legislation passed to increase the embargo and put pressure on Castro. There is legislation which I am sponsoring along with many of my Democrat colleagues, and Senator Helms in the Senate, to tighten the noose around Fidel Castro's neck. Yet, here we have Morton Halperin at the White House in the NSC who could not be confirmed as Assistant Secretary of Defense, pulling strings to try to normalize relations with Castro.

Once again, there is unilateral action being taken by the administration, and we go on and on and on where there has been unilateral action.

This is something that I think should not be tolerated by Democrats or Republicans in the Congress. The President should make his case to the peoples' House and to the Senate before he takes these kinds of actions, because he is spending taxpayers' dollars by much more than a bushel.

My colleague just commented about Secretary Rubin, and I just read Jim Leach's column in the *Washington Post*. He said Secretary Rubin has no ethics conflict here.

That may be the case, but there certainly is the appearance of impropriety, and let me tell you why. I want my colleagues to listen to this. Secretary Rubin was the boss at Goldman Sachs. They invested $5.17 billion in Mexican bonds and other investments down there.

They were the largest investor in Mexican investments by far of any investment house in the United States. In fact, I think they were the next two combined did not total what Goldman Sachs put down there. He had a lot of his own personal investments in Mexico.

One of his clients was the Mexican Government. In 1993, as head of the National Economic Council, Secretary Rubin recused himself, because he did not want there to be the appearance of impropriety. Yet, when the Mexican bailout comes, and they cannot get the bailout passed through the Congress, Secretary Rubin does not recuse himself; even though he put a lot of peoples' money—$5.17 billion—in Mexico from Goldman Sachs.

He, as the Secretary of the Treasury, took unilateral action with the consent of the President to send $20 billion out of the Exchange Stabilization Fund to Mexico without any support from Congress.

If that is not the appearance of impropriety, I do not know what is. I applaud my colleagues on the Banking Subcommittee who are going to call Secretary Rubin before that subcommittee to explain these possible improprieties.

Mr. BERMAN. Would the gentleman yield?

Mr. BURTON. I would be happy to yield in just a minute. The bottom line that this administration needs to know, and I hope you will convey this, Mr. Summers, is that this is a republic.

Here, as I believe Mr. Jefferson said, the people rule. The President of the United States is not a dictator. He should not take unilateral actions without consulting with, and working with the Congress, and making his case before the people.

Yet in the case of Haiti, Mexico, Vietnam, and now Cuba and striker replacement on public contracts, he is taking action unilaterally without bringing his case, and making his case before the Congress of the United States.

I think that is deplorable. The people of this country ought to take the President to task, and I am not saying this in a partisan way. There are a lot of Democrats on the other side of the aisle that feel just as strongly about this as I do.

If the President wants to have a good working relationship with the Congress during the next 2 years, he better get on the ball and start working with us instead of taking these unilateral actions.

Mr. BERMAN. Is the gentleman yielding?

Mr. BURTON. I yield to my colleague.

Mr. BERMAN. I thank the gentleman for yielding. I am curious to know, given that the gentleman has chosen this forum to sully the reputation of the Secretary of the Treasury, whether he has specific facts behind his allegations that Mr. Rubin personally profited by virtue of what Goldman Sachs, or any other investment banking house might have——

Mr. BURTON. I said there definitely was the appearance of impropriety.

Mr. BERMAN. By the——

Mr. BURTON. No, let me finish.

Mr. BERMAN. Appearance to whom?

Mr. BURTON. Mr. Rubin made $26 million from his clients. One of his clients was the Mexican Government. That is a matter of record. His firm was the largest investor in——

Mr. BERMAN. His firm. Is he a member of this firm now?

Mr. BURTON. Goldman Sachs of which he was the head, was the largest investor in Mexican securities, by far. Almost double any other.

He did recuse himself in 1993, but in 1995 he decided not to as Secretary of the Treasury, and decided to take this unilateral action. The bottom line is that he needs to come before the Congress and answer these points. With that, I yield back the balance of my time.

Mr. BERMAN. Mr. Chairman.

Chairman GILMAN. Does the gentleman from California want to make an opening statement? Our time is running.

Mr. BERMAN. It is running, and I came here to hear the witnesses, but I just simply want to say until the gentleman presents at least some minimum of a prima facie case that at this particular

time, the Secretary is profiting beyond what every American might be profiting by virtue of a wise decision, if it is a wise decision, then I think the gentleman, I think decency would require the gentleman to find out the facts of the economic profit before he starts throwing all of this stuff around.

Mr. GEJDENSON. Would the gentleman yield?

Chairman GILMAN. If there are any other opening statements?

Mr. BERMAN. The gentleman——

Mr. GEJDENSON. Mr. Chairman.

Chairman GILMAN. Mr. Gejdenson.

Mr. GEJDENSON. I just think, furthering Mr. Berman's comments, I think there are certainly issues to debate here on the Mexico situation, but I think that it is not helpful to the reputation of this body, or this committee, to start off with an assault on the Secretary of the Treasury.

I think that we can have a serious debate about this without trying to create the appearance of impropriety. I think that everybody who knows the Secretary of the Treasury, knows this is an individual of the highest character, and whether you agree with his conclusion, or the President's conclusion, I think that one of the mistakes that we have made in this body on the floor, and I commend the speaker for his new rules which restricted members' ability to attack the speaker on his book deal on the floor, and other attacks on other members, is that we ought to debate the issues, and not constantly try to attack the character of the individual with whom we have disagreements.

Chairman GILMAN. I thank the gentleman, and in order to get to the issues, I would like to allow our panelists to have enough time, Mr. Brown, for an opening statement.

Mr. BROWN. Mr. Chairman, thank you. Two years ago, Mr. Chairman, I was an outspoken critic of NAFTA. I realize that my friends in the administration claim that NAFTA's completely unrelated to the current problems in Mexico.

I will admit that NAFTA cannot be blamed for Carlos Salinas' recent bizarre behavior, but NAFTA is indeed a factor in the current turmoil south of the border. I want to remind my colleagues that many of us who opposed NAFTA, Congressman LaFalce, Congresswoman Kaptur, several others and I, continually harped on the need for a side agreement on currency.

I made a recommendation in person to trade representative Cantor and got no action from his office, and both a dismissive press and a dismissive administration.

During the NAFTA debate, I referred to the NAFTA agreement as a shotgun wedding. The purpose of recounting this is not to say on the part of any of us that we told you so. The purpose is to illustrate that NAFTA, by linking the U.S. and the Mexican economies by marrying our two economies, if you will, was not a risk-free proposition.

I did not then, and do not now believe that NAFTA served the best interest of our country, neither workers nor businesses. I thought the agreement would serve to beggar both countries, to drive businesses to the low wage climate of Mexico, and then drive wages down for workers in this country and south of the border.

I believed then as I believed now that NAFTA was primarily an investors agreement, a way to ensure American capital against losses from events such as those we now see underway in Mexico—economic and political upheaval that threatens to spiral out of control for both countries.

But it is hard for me, Mr. Chairman, to sit and listen to some of my colleagues who supported NAFTA to rail against the peso bailout and how it helps Wall Street investors. What did they think NAFTA did?

I am also tired of listening to Republican colleagues who voted for NAFTA talk about Mexico's corrupt government. What did they think Mexico's Government was before NAFTA when they voted for it?

And I am tired of listening to Republican colleagues who voted for NAFTA attacking Mexico's elite and the profits that they are making on all of these kinds of trade agreements. What did they think those Mexicans of the Mexican elite was doing before NAFTA passed.

The question, Mr. Chairman, is where does that leave us? The dollar continues to sink to new postwar lows against the yen and even the German mark. The *New York Times* today said the recent plunge seems to have been driven by an odd melange of concerns.

One is that the administration would get sucked deeper into Mexico's financial crisis which deepened as the peso fell to a record low against the dollar.

Mr. Chairman, we must figure out how to de-link the Mexican and U.S. economies. Certainly we have some ties that cannot be broken. We will continue to trade with Mexico as we should, although clearly our deficit with Mexico will continue to soar in light of the peso's collapse.

The challenge for the administration and the State Department is to in effect an amicable divorce, recognizing that it is a monumental mistake to tie our country with the largest consumer market in the world, and the envy of other nations, to tie our country to the Mexican economy which is one-ninth the size of ours, and infinitely less stable.

We must not allow the peso to cause the collapse of the U.S. dollar. We should trade with Mexico. We should continue to maintain close diplomatic relations. We should work closely with Mexico on such issues as drug interdiction, on illegal immigration and environmental problems, but to make Mexico the centerpiece of our economic and foreign policy is purely a tragic mistake.

Today I will do something unusual for a politician. I will admit that I do not know the answer to the currency crisis. I do not know how we are going to get ourselves out of this mess.

What I do know is the State Department should begin immediately to devise a fail-safe strategy, to devise a policy of, for a lack of a better term, constructive disengagement.

We rushed into Mexico as if there were no tomorrow 2 years ago. Out of commercial interest, we overlooked the turmoil in that country. We ignored the fundamental economic, social, and political inequities that make Mexico a potential volcano.

We got burned. Now we have to make a bad situation better. It should be a bipartisan process. As a bitter opponent of NAFTA, I

call upon members on the other side to cool the hot rhetoric, to resist just once the opportunity to blame the President for everything but the weather. We have too much at stake to engage in partisan sniping. We must return to the days when foreign policy stopped at the water's edge, except in this case, it stops along a 2,000 mile border.

Mexico is not going away. The Mexican people are not going away. Isolationism is not the answer. Neither is a heated rush to marry two very different economies so widely separated in terms of wages, in terms of labor law, in terms of environmental law.

We must expand cultural exchanges, help Mexico build a civil society and build democratic institutions. What we do not need right now is more finger-pointing.

We need to develop a new strategy, a new policy, a third way of dealing with the country on our southern border.

I look forward to working with the administration on such a realistic bipartisan policy.

Chairman GILMAN. I thank the gentleman. May I remind my colleagues, we are already into 40 minutes of that first hour.

Mr. LANTOS. Mr. Chairman.

Chairman GILMAN. The folks' testimony.

Mr. LANTOS. Mr. Chairman.

Chairman GILMAN. Yes, Mr. Lantos.

Mr. LANTOS. It is part and parcel of the process of a congressional hearing that members who are intensely interested in the topic express their points of view. You are implying with your constant rushing of this body that we are wasting somebody's time.

We are not wasting anybody's time. I thought the gentleman from Ohio made an outstanding statement. I learned a great deal from it. So did everybody else who listened to it. He should be commended for his statement.

This mania, the 100-day concept that this is like a gas station where we do lube jobs, and we have a quota to meet is too antithetical to a deliberative body.

I resent the constant urging to move on with the job. We are on the job. We were here at 10 o'clock. The chairman came late. We have been sitting here patiently. We do not wish to be rushed.

Chairman GILMAN. Mr. Lantos, I think your criticism is unwarranted. We started this hearing at 10:05. We are now into 45 minutes before the witnesses have an opportunity to be heard.

The purpose of the hearing is not to limit the debate, but to get the testimony of our experts before us, and then to get into the debate, and I was not criticizing the gentleman's remarks. They were excellent.

My only concern is to be able to move the hearing along, in consultation with the ranking minority member. We thought a better method would be to limit opening remarks to just the ranking member and the chairman, and then to proceed in the future.

Mr. Hastings.

Mr. HASTINGS. Thank you very much, Mr. Chairman. Mr. Chairman, I have listened real intensively to my colleagues on both sides of the aisle, and I find very little to disagree with, but rising to the criticism that we offer after the fact serves no useful purpose, and therefore I would like to associate myself with the ending remarks

of my colleague from Ohio, and put the question to all of us, since Congress did not have the political will to do anything in the face of imminent collapse of Mexico's financial stability, and had the President done nothing, I wonder what the hell would have happened?

Thank you.

Chairman GILMAN. Thank you, Mr. Hastings, and now Mr. Tarnoff, finally, your testimony.

STATEMENT OF PETER TARNOFF, UNDER SECRETARY OF STATE

Mr. TARNOFF. Thank you, Mr. Chairman and members of the committee. I welcome this opportunity to appear before you here today, and to discuss our relations with Mexico.

Mr. Chairman, I have a somewhat longer statement which I will file for the record, but in the interests of time, I will abbreviate that.

Chairman GILMAN. Mr. Tarnoff, could you put the mike closer to you? Much closer please. Thank you.

Mr. TARNOFF. In the interests of time I will abbreviate that statement so as to permit my colleague, Mr. Summers, and the members of the committee to have more time of their own.

The United States' fundamental interest, both economic and political in a stable and prosperous Mexico—first, what happens in Mexico affects are economic security. Mexico is our third largest trading partner—American exports, jobs and investments are greatly impacted by Mexico's economy.

In our interconnected world, markets closely monitor how we and major international financial actors treat a crisis in an emerging market. We have an interest represented by Americans whose jobs and savings are affected by our exports and investments abroad, in minimizing the destruction caused to the international financial system by the financial situation in Mexico.

My colleague, Under Secretary Summers, will address these issues more fully.

Second, what happens in Mexico affects our quality of life, particularly in the Southern States. We have 100 million Mexican neighbors, and a 2,000-mile border. Our common history and this geography present challenges in migration, law enforcement, narcotics interdiction, and protection of the environment which we have and will address together.

Third, we have a national interest in promoting regional progress in opening markets and political systems, as the consensus of the Summit of the Americas so powerfully demonstrates.

Over the last decade, Mexico has made extraordinary progress in this regard. The elections last August were the most transparent in Mexican history. President Zedillo has pledged to continue the reform process, and has already taken several significant steps to do so.

It is in our interest to see Mexico succeed.

Finally, we have an interest in maintaining America's leadership in the region.

On the question of the financial support package, very briefly, these national interests compelled the United States to lead the effort to respond to the financial crisis in Mexico.

The ultimate success of this program, of course, depends on Mexico itself. The Mexican leadership has made clear that it is prepared to take the stringent economic measures needed to overcome the crisis. The disbursement of American funds will follow our determination that Mexico has indeed pursued sound policies.

Repayment is backed in a binding agreement by proceeds from the exports of crude oil and petroleum products.

Mr. Chairman, we have acted to protect America's interests, and have done so in a way which minimizes our risks. With the stakes as high as they were, the United States could not have failed to exercise leadership.

History would have judged us harshly had we stood idly by and allowed Mexico to drift into chaos, leaving the economies of other friends and partners to be disrupted.

With regard to our important bilateral agenda with Mexico, our ties to Mexico involve much more than economic and commercial matters. Millions of people cross our common border legally every year, but the border relationship is a complex one. It entails a number of important issues including the crossing of illegal migrants, the flow of illegal narcotics, other law enforcement concerns, and environmental issues on which we must cooperate.

Let me review briefly where we stand on several of these issues. On migration, Mexican authorities are cooperating with the immigration and naturalization service in taking numerous steps to curb crime and violence along the border, and the illegal smuggling of undocumented migrants.

The binational commission working group on migration and consular affairs had a productive meeting on February 13, 14 in Zacatecas, Mexico in which the Mexican Government proposed a series of actions for intensified cooperation.

For example, the Mexicans agreed to expand the elite Grupo Beta police force to two additional border cities in 1995. Already deployed in Nogales and Tijuana, the Grupo Beta has proven to be an effective instrument in detecting and deterring crimes against migrants, including alien smuggling.

I am pleased to tell you that the Mexican Government has taken other concrete steps to implement commitments it made at the Zacatecas meeting. Already additional police officers have been sent to Tijuana to raise port security and stop migrants from running through the port.

The INS has been allowed to share control over border gates to help ensure they stay locked when not in use. The notorious Nogales tunnels, through which migrants and intending criminals have entered into the United States illegally, are now subject to stricter security measures.

On Mexico's southern border, tighter controls are in place to deter third country nationals who seek to transit Mexico illegally on route to the United States.

On the question of counternarcotics and law enforcement, our two governments are firmly committed to fighting the scourge of drug trafficking and production of illicit narcotics which are, in the

words of President Zedillo himself, Mexico's most serious national security problem.

President Zedillo has launched a broad-reaching judicial reform and anticorruption effort in part to strengthen his government's ability to oppose narco-traffickers.

Although there is certainly room for improved cooperation, particularly in the interdiction of cargo jets, we believe the government of Mexico is serious about combating drug trafficking. Over the past 6 years, our cross-border cooperation has lead to seizures by the Mexican Government of over 120 metric tons of cocaine, tens of thousands of arrests, and the eradication of thousands of hectares of opium poppy and marijuana.

In February, we held two very constructive meetings in Mexico City on narcotics and law enforcement issues. The two sides discussed concrete measures to intensify cooperation in combating narcotics trafficking, and in apprehending and bringing fugitives to justice.

Let me say a few words about the discussions we have had on the transfer of Mexican prisoners from U.S. jails to serve their sentences in Mexican prisons. In 1978, the United States and Mexico signed a treaty that permits prisoners to be transferred to their country of nationality to serve criminal sentences imposed in the other country.

This year Mexico is committed to accepting up to 400 prisoners, and to exploring ways to expand its prison space so that more prisoners can be returned in the future. Its current plans calls for expanding prison capacity by approximately 16,000 spaces.

On the environment, joint undertakings to protect our shared environment date back to the establishment in 1889 of what is today the International Boundary and Water Commission.

In addition, the Mexican Government is working with the EPA and other U.S. Government agencies to develop a new and comprehensive action plan to address border environment issues under the La Paz agreements.

As a result of NAFTA, however, we have two additional and unique bilateral institutions—the border environment cooperation commission known as the BECC, and the North American Development Bank, or NADBank.

Together, these two institutions will help develop and finance badly needed environmental infrastructure along the border.

These issues, Mr. Chairman—immigration, law enforcement, counternarcotics, environmental safety—are important to all of us. We are greatly encouraged by the level of cooperation we enjoy with Mexico, but we will continue to press for even greater accomplishments.

Fundamental to continued progress on these and other issues is the basic stability of Mexico, both politically and economically. President Zedillo has committed to political reform to complete Mexico's transition to full democracy, and the headlines bear out the bold steps that he is taking.

The process of return to economic stability has been launched thanks to U.S. support and leadership.

Another major area of our relationship in Mexico is foreign policy. We are in close agreement and cooperate well with Mexico on

many issues, however we must recognize that on Cuba, while we share with Mexico the determination to help bring about a peaceful transition to a democratic government there, we differ with Mexico on how to achieve this goal.

Mexico prefers the strategy of engagement to bring this about. We believe in isolating the Castro regime. In the last several years, Mexico has sought closer economic cooperation with Cuba, both to settle Cuba's outstanding debts to Mexico, and to position Mexican firms for the expected post-transition boom.

As part of this effort, Mexico has promoted a number of debt for equity agreements leading to the acquisition of shares in Cuban entities by Mexican firms.

We have repeatedly expressed our concerns, but Mexico, like Spain, Canada, and other U.S. allies, pursues other means to promote reform in Cuba. In our ongoing dialogue on this issue, the Mexican Government has informed us that it will not settle Mexican debt claims against other governments such as Cuba, through mechanisms involving the transfer by such governments of expropriated properties for which the U.S. nationals or companies have unresolved claims for compensation or ownership.

Further, the Government of Mexico's policy is not to provide assistance to the Government of Cuba, and to deal with Cuba only on a commercial basis on market terms. The Government of Mexico has indicated that it does not offer subsidies or concessionary prices to Cuba, and the United States has no evidence that this is not the case.

On the important issue of Mexican political reform, Mexico is continuing its profound political and economic transformation. President Zedillo has been adamant about the need to make Mexico a full democracy. He has pledged additional electoral reform, in particular on campaign and party financing, media access, and greater autonomy of electoral institutions.

He pledged to separate his administration from the ruling party, the PRI, and himself from internal PRI decisionmaking. So far, after only 3 months in office, he is fulfilling his commitments.

He has recognized the urgent need to reform the Mexican judicial system. In December, he introduced constitutional amendments to improve the accountability of the Supreme Court and the Attorney General's office.

He instructed the Attorney General, the first opposition party cabinet member since the PRI took power in Mexico, to oversee a transformation of the entire system of justice and law enforcement.

President Zedillo has taken bold steps to build a political consensus, consulting with the leadership of all major parties. The dynamic Attorney General is a member of the PAN Party, and the first opposition member ever to hold a cabinet position.

Zedillo invited the leaders or the opposition PRD and PAN Party to meet with him, and he subsequently met with all the opposition parties on January 17 in a session which resulted in a general agreement toward political reforms, unprecedented in Mexico's history.

President Zedillo has attempted to boost Congress' role in governing. For example, by inviting the participation of a congressional commission in the Chiapas peace process.

On February 12, we witnessed a major step forward in Mexico's democratic reform process. Elections in Jalisco, in which the PAN won a resounding victory, were conducted without incident, and the results were accepted by all parties.

The Jalisco vote was a clear sign that Mexico is evolving into a genuinely competitive, multiparty democracy.

As Mexico has implemented this reform, it has grappled with political turmoil over the past year. As we have witnessed in the past 2 weeks, Mexican authorities are aggressively pursuing investigations into high level assassinations.

President Zedillo pledged to the Mexican people that his administration would reinvigorate the judicial probes of the murders of PRI candidate Colosio, party leader Ruiz Masseiu, and Cardinal Posadas.

The arrest of Raul Salinas in the Ruiz Masseiu investigation validates Zedillo's promise to pursue justice no matter where it leads. The Government of Mexico's efforts to ensure former Deputy Attorney General Ruiz Masseiu's return to Mexico to further illuminate possible efforts to block the investigation of his brother's murder further underline the commitment that President Zedillo has made to full investigations in these cases.

In Chiapas, Mr. Chairman, President Zedillo sought to reopen avenues of dialogue with the EZLN, but their intransigence and their attempts to expand the conflict to areas outside Chiapas lead him to order the military to regain authority over territory in Chiapas.

Zedillo reiterated his commitment to peaceful resolution by halting the military offensive after legal order had been reestablished. He has called for a special session of the Congress which is convening this week to approve legislation addressing the underlying causes of the problems in Chiapas, and providing the guidelines for an amnesty.

He accepted the resignation of the governor of Chiapas, long a Zapatista demand. In these efforts, Zedillo has the support of the multiparty congressional peace commission which is playing a key role in the peace process.

Our position has been very clear regarding Chiapas. Governments have the right and the responsibility to protect their citizens against violence, but they must at the same time respect fundamental human rights.

We continue to urge restraint, respect for human rights and full compliance with the legal processes in Chiapas.

Mr. Chairman, by way of conclusion, we believe that Mexico is on the path to financial recovery to a more secure expression and implementation of democratic goals and to economic well-being for its people.

The path is not an easy one, and will require great sacrifices on the part of the Mexican people. President Zedillo is determined to succeed. President Clinton and this administration are determined to assist Mexico because we are neighbors and friends, and because it is in our Nation's overriding security and economic interest to do so.

Let me close by highlighting for you once again the significance of the President's decision to authorize the stabilization fund for Mexico.

In so doing, he not only lead the international effort to resolve the potentially dangerous liquidity crisis in a key trading partner and neighbor, he demonstrated that the United States is prepared to play its unique leadership role in a region emerging into democracy and economic liberalization.

He signaled that the United States would play its part, ensuring that the mutual cooperation and support pledged at least year's Summit of the Americas would be an enduring relationship.

The institutionalization of democracy and free markets throughout the region ensures our own domestic order and prosperity here at home.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Tarnoff appears in the appendix.]

Chairman GILMAN. Thank you, Mr. Tarnoff. Mr. Summers.

STATEMENT OF LAWRENCE SUMMERS, UNDER SECRETARY OF THE TREASURY FOR INTERNATIONAL AFFAIRS

Mr. SUMMERS. Thank you, Mr. Chairman. Mr. Chairman and members of the committee, I appreciate the opportunity to appear before you today to discuss the U.S. response to Mexico's financial difficulties.

Before I read my statement, I might just say to the chairman that I recognize that there are many concerns and questions that are valid and need to be debated about this program. My intention and remarks to which the chairman referred was not to cast doubt on the intentions of those in either party who have raised questions.

My intention was to underscore the administration's commitment, my own personal commitment to the idea that the United States must take a leadership role in international affairs, and only to do that.

Chairman GILMAN. Mr. Summers, could you place the mike a little closer to you please? Thank you. A little more closer.

Mr. SUMMERS. How is that?

Chairman GILMAN. Thank you.

Mr. SUMMERS. Now going back to my statement. On January 31, President Clinton, with strong bipartisan support from congressional leadership, announced his decision to offer a $20 billion support program to Mexico.

The congressional leadership joined with the President that day in stating that immediate action was needed to "protect American jobs, prevent an increased flow of illegal immigrants across our borders, ensure stability in the hemisphere, and encourage reform in emerging markets around the world."

In my written statement to the committee which I have submitted for the record, I have reviewed many of the events leading up to the President's decision, as well as the details of the financial agreements signed by Secretary Rubin on February 21 implementing the program.

In my oral statement this morning, I would like to address four of the more frequently asked questions regarding Mexico's financial situation, and the U.S. support effort.

One concern often raised is the extent to which the United States is assuming financial risks by offering support. I want to emphasize that in designing these agreements, Secretary Rubin has taken every conceivable precaution to minimize risks.

Mexico's return to economic stability depends on Mexico pursuing the right economic policies. That is why U.S. support is contingent on Mexico's commitment to following rigorous monetary, fiscal, and structural policy conditions.

These include obligations to pursue negative real money growth, and a budget surplus of half a percent of GDP, which Mexico agreed upon when it accepted IMF support in January.

U.S. assistance will not serve its purpose if Mexico misuses our support. That is why Mexico's use of our support is governed by a financial plan, which requires the United States to approve the use of each and every disbursement.

The United States will disburse support to Mexico in stages, following Mexico's disclosure of its plans for using any new disbursement. The United States may reject any disbursement if Mexico's planned use of funds received is inappropriate.

Accelerated repayment clauses further protect the United States if Mexico fails to meet key conditions of our support.

Provision of U.S. support has been made contingent on Mexico's living up to the important transparency and financial reporting requirements. New public disclosures will include monthly data on government securities and banking operations, quarterly reporting on a host of monetary aggregates, fiscal revenues, public sector borrowing operations, developing bank operations, and trade and balance of payment statistics.

Let me also emphasize that this support is being provided at a price to the Mexican authorities that recognizes, and indeed, substantially exceeds any possible risks.

The premiums will begin at 2¼ percent above Treasury bill rates. They will rise the more support is disbursed, to 3¾ percent. That will encourage Mexico to turn to regular private market sources for capital.

All of these provisions minimize the risk faced by the United States. However, in the unlikely event that Mexico cannot meet any obligations under these accords, they are backed by Mexican proceeds from oil and oil products exports, through a new oil mechanism that improves on mechanisms which have been used to back previous Mexican obligations to the United States.

Under the new mechanism, Mexico's customers have been given irrevocable instructions to make payments directly to a U.S. bank from which proceeds will flow to the New York Federal Reserve Bank. They can be used to repay the United States if Mexico does not meet its obligations to us.

In the final analysis, the United States is not an ordinary creditor for Mexico. The United States has provided dollars to Mexico through the exchange stabilization fund six times since 1982. Mexico has fully repaid its obligation under all of these facilities when due for repayment.

A second question that has arisen is whether the President acted within his authority in deciding to use the sources of the Exchange Stabilization Fund. The bipartisan congressional leadership, the Department of the Treasury's General Counsel in an opinion letter dated February 21, and the Department of Justice have all investigated this issue exhaustively, and their answer is unambiguous.

The President and the Secretary of the Treasury have clear legal authority under the ESF statute to provide Mexico with assistance in the present manner to maintain orderly exchange rates and a stable system of exchange rates.

The bipartisan leadership acknowledged that authority in their joint statement with the President on January 31, declaring that the President has full authority to provide this assistance.

I want to emphasize that the administration intends to keep Congress fully informed of the progress that we are making in implementing our support package. Secretary Rubin has written to the bipartisan leadership assuring them that in addition to the Department of the Treasury's regular classified monthly reports to the banking committee on Exchange Stabilization Fund operations, "we intend to prepare on a regular basis a much broader report to provide Congress with a detailed picture of developments in Mexico and compliance with our agreed economic terms and conditions."

I would also say that Secretary Rubin and Chairman Greenspan, along with their staffs, devoted very considerable attention to the question of whether the use of the Exchange Stabilization Fund would in any way diminish the capacity of the United States to defend the dollar in the event that a situation arose where that was necessary.

It was their conclusion that the use of the Exchange Stabilization Fund for that purpose would in no way diminish the capacity of the United States to defend the dollar. Had their conclusion been different, I suspect they might have acted different.

Let me note also in terms of the monitoring of this program, that the Mexicans have undertaken, as a condition of our support, commitments to provide a broad new array of financial and economic data.

A third important question involving Mexico's financial difficulties is how the United States and international support package will work to restore Mexico's economic health.

Two points should be emphasized. First, Mexico's economy is fundamentally a sound one. Nearly 1,000 state industries have been sold off. Tariffs have been slashed way back to zero on more than one-half of U.S. exports.

Barriers to investments have been removed. Public debt as a proportion of GNP have declined substantially to a point below the OECD average, and the government has taken sufficient fiscal actions to reduce their budget deficit by the equivalent to five Graham-Rudman programs.

The problem lie in the short-term problem of confidence. As with the bank which suddenly suffers a loss of confidence, experiences a bank run, Mexico's chief problem is one of liquidity which our support package will address.

A sharp fall in investor confidence has made it impossible without support for Mexico to refinance short-term debt falling due as it could under normal market conditions.

The U.S. and international support package will mitigate that problem by providing Mexico with the funds necessary for Mexico to redeem short-term obligations, shifting its debt portfolio to longer term, less volatile forms of finance.

International support program put in place has already helped to reduce the stock of short-term dollar index securities, desa bonos, from roughly $30 billion outstanding at the beginning of the year, to about $18 billion currently.

By year-end 1995, Mexico's financial plan projects that only $5 billion of these securities will remain outstanding.

Ending Mexico's short-term liquidity crisis is one key to success, but ultimately Mexico's success depends upon the implementation of sound macroeconomic policies in Mexico that will correct the macroeconomic policy errors of the last year.

Our support package is based on Mexico's commitment to pursue the rigorous monetary, fiscal and structural policies to which it agreed in accepting IMF support in January, and which it elaborated further in the economic policy memorandum which is one part of our agreement.

That memorandum declares that a chief goal of Mexican economic policy will be to stabilize the currency and to strengthen the policy, strengthen the peso. Mexico's commitments will provide the foundation to help Mexico meet that goal. It will seek negative real money growth, substantially positive real interest rates.

The government budget will move to a surplus. Privatization will be accelerated. I believe that these reforms, if pursued steadfastly, give the Mexican economy the capacity to grow once again, to build on the foundation of structural reforms which have taken place in the last 7 years.

Patience will be required. Markets will remain nervous. Mexico will surely go through a period of economic slowdown before the fundamental health and flexibility of the Mexican economy and the Mexican people reassert themselves.

Finally, many have asked about the lessons that can be drawn from the Mexican experience. We have learned that certain old truths about unsustainable economic policies have become even more true in the age of rapidly moving money.

For all the benefits they bring, international capital markets also impose great policy discipline. As Chairman Greenspan explained in his testimony before the house, a combination of policies pursued by the Mexican Government during the last year was not sustainable, and ultimately reached a limit at which point the exchange rate had to be devalued.

As last year unfolded, Mexico continued to experience political and economic shocks. The sustainability of its macroeconomic policy fell increasingly into doubt. While based on Mexico's past track record, many commentators and analysts predicted an imminent resumption of capital in-flows, U.S. officials became increasingly concerned.

Treasury and Federal Reserve officials at a range of levels, warned their Mexican counterparts that Mexican policy could well

prove unsustainable. Unfortunately, the Mexicans ignored these warnings. Rather they held fast to the view that the country's loss of reserves did not call for policy adjustments and would ease once political shocks ended.

The Bank of Mexico continued to sterilize its out-flow of foreign currency, buying government debt with pesos, and increasing the money supply, but political shocks continued, and policy adjustments were not made. The rate of reserved accumulation became so rapid that in the end, Mexico found that it could no longer defend the peso.

Unfortunately, as the Mexican authorities have since acknowledge, the devaluation, while inevitable at the time it took place, was poorly handled. In conjunction with a number of political shocks that followed, it diminished confidence so sharply that by January the possibility of default which had seemed nearly unthinkable only a month earlier, became a real possibility.

A second lesson we have learned from Mexico's difficulties is how important it is for developing nations to forge ahead with structural policies along with macroeconomic policies in order to attract long-term investment.

Mexico has come very far, but continued privatization and institutional reform will be needed. It will ensure the capital continues to find Mexico an attractive site for investment and growth, making Mexico less vulnerable to a reversal in short-term capital flows.

And of course, the institutional reforms are not only about capital. Some of the most fundamental institutional reforms in Mexico that are needed are directed at making prosperity more inclusive by supporting measures directed at some of the same kinds of things that President Clinton has stressed here in terms of investing in people if Mexico's economy is to rest on a stable base.

Finally, Mexico's experience reminds us that the time has come for a review of the international, economic and financial architecture. As President Clinton and the G–7 leaders recognized at their Naples summit in setting the agenda for the Halifax summit, we need to think profoundly about the kind of institutional mechanisms that we can forge to prevent and address problems of this kind in the future.

Allow me to conclude by emphasizing that the administration has not acted to protect Mexican interests, as close an ally and partner as Mexico is. Rather, President Clinton acted to protect U.S. interests—jobs, exports, immigration concerns, security issues that would have been threatened by the failure to act.

Mexico's financial instability highlights as well as markedly as any recent event with all the benefits as well as the challenges that we face in an increasingly interconnected financial world.

Proper response to these challenges in my view is to continue to assert U.S. leadership.

Thank you.

[The prepared statement of Mr. Summers appears in the appendix.]

Chairman GILMAN. Well, I want to thank our panelists for their expert opinion. Mr. Summers, what policy advice did you give the Mexicans last year when it became apparent that their economic policies were unsustainable?

It has been reported that you recommended to the Mexican Government that they should devalue the peso. Was that your advice?

Mr. SUMMERS. Congressman, I want to give you as full an answer as I can on behalf of the Treasury Department and other U.S. financial officials. I am advised that because of executive orders, I am not able to get into the details of specific conversations that took place.

I can say to you that American officials warned their Mexican counterparts repeatedly and with increasing urgency as the year went on that policy was on an unsustainable path in Mexico, and that unless adjustments were made, which could have been made in a number of different directions, that the situation was likely to become a very, very difficult one.

Our warning was that Mexico was borrowing at a rate, borrowing and creating credit at a rate that was inconsistent with the exchange rate that it was maintaining.

Chairman GILMAN. Specifically then, did you recommend they should devalue the peso with all of those admonitions?

Mr. SUMMERS. We recommended that they should take one of a number of possible steps to put policy on an unsustainable course.

We did, it was our view that in the event that, unless there were significant adjustments that were made in Mexican policy, Mexico would, because of the loss of reserves, face no alternative but to devalue.

Chairman GILMAN. So then it was your advice to devalue the peso.

Mr. SUMMERS. No, it was—no, Congressman, it was the advice of U.S. officials that Mexican policy was unsustainable.

Chairman GILMAN. Were you part of that advisory group?

Mr. SUMMERS. I shared the view as did, I believe, all of the U.S. officials who were involved in this question above and below my level at the Treasury and the Federal Reserve, that Mexican policy was unsustainable, and that it was appropriate for the Mexicans to make some form of adjustment.

Chairman GILMAN. This——

Mr. SUMMERS. That was not the view of many others in the markets who advised the Mexican Government, and of some officials in Mexico who felt that if Mexico simply proceeded along the path that it was on, confidence would return and capital would flow.

Chairman GILMAN. Do you still feel that was sound advice, to devalue the peso?

Mr. SUMMERS. Congressman, I believe that events have born out the view that I have expressed, that Mexican policy was unsustainable during the last year, that it was appropriate for the Mexicans to take some action to put policy on a sustainable path.

That could have involved a number of different policy adjustments including changes in credit policy, including policies directed and encouraging the in-flow of capital. I believe that as Chairman Greenspan suggested in his testimony, that at the time that the Mexican authorities devalued in late December, the rate of loss of reserves was such that they had no alternative, and so when they notified us after the decision had been taken of that decision, I did not feel I could quarrel with it.

Chairman GILMAN. So you would agree then that a decision to devalue was appropriate at that time, is that correct? Am I analyzing your statement correctly?

Mr. SUMMERS. Mr. Chairman, it was the judgment following notification by the Mexican authorities of their devaluation because in the judgment of the Mexican authorities, they had no alternative on December 20. It was the judgment of U.S. financial authorities that they were correct, that they had reached a limit and that at that point, they had no alternative.

Chairman GILMAN. And then——

Mr. SUMMERS. At earlier junctures, I think that there were a range of alternatives that were open to the Mexican authorities.

Chairman GILMAN. Right, and you agreed with that judgment.

Mr. SUMMERS. I would agree with the judgment, and I believe I am speaking for—I believe other U.S. financial authorities would agree with the judgment that at the point at which the currency was allowed to float, there was no alternative, given the rate at which reserves were being lost, and given the market conditions.

Chairman GILMAN. Is the report today in the *Washington Post* accurate that Mexico has already drawn down $3 billion from the Exchange Stabilization Fund?

Mr. SUMMERS. Congressman, the Mexican authorities have not drawn to date on the $20 billion Exchange Stabilization Fund facility that has been the subject of our discussion. They have drawn on the earlier short-term facility, $1½ billion from the Treasury, and $1½ billion from the Federal Reserve.

Chairman GILMAN. So they have drawn down $3 billion at this point.

Mr. SUMMERS. They have drawn $3 billion in short-term, in short-term swaps, half from the Exchange Stabilization Fund, and half from the Federal reserves. That will count with respect to the $20 billion cap.

Chairman GILMAN. Are we going to wait to see an economic stabilization plan in place in Mexico before we commit resources under the ESF?

Mr. SUMMERS. At the time of the agreement on February 22, the—February 21—the Secretary of the Treasury stated that $3 billion from the Exchange Stabilization Fund would be made available in part through a roll-over of that short term swap, and would be made available when the agreement became legally—when it became formally legally effective, and when a formal request was made by the Mexican Government.

So when those things take place, I would expect that the Secretary of the Treasury would be prepared to authorize a disbursement. Any subsequent disbursements, of course, will depend upon a very careful and close evaluation of Mexican economic policy.

Chairman GILMAN. So the first draw-down would not be dependent upon an economic stabilization plan being in effect, is that right?

Mr. SUMMERS. The first draw-down is based on the Mexican commitments that were entered into with the United States based further on their IMF commitments addressing their budget situation, addressing their monetary policy in the February 21 agreement.

Chairman GILMAN. I do not think you are answering my question. I am asking is that next draw-down going to be dependent upon an economic stabilization plan being in place?

Mr. SUMMERS. Yes.

Chairman GILMAN. Before there's any draw-down.

Mr. SUMMERS. Yes.

Chairman GILMAN. The answer is yes.

Mr. SUMMERS. Yes.

Chairman GILMAN. Thank you. Mr. Hamilton.

Mr. HAMILTON. Thank you very much, Mr. Chairman. I ask unanimous consent that the memorandum that the General Counsel of the Treasury on the Exchange Stabilization Fund be inserted in the record.

Chairman GILMAN. Without objection.

Mr. HAMILTON. And that I be permitted to submit some questions.

Chairman GILMAN. Without objection.

[The materials referred to appear in the appendix.]

Mr. HAMILTON. Mr. Summers, I am interested in some of the linkages here—the linkage between the Mexican loan package and what is happening to the dollar, the linkage between the loan package and NAFTA.

You heard a number of my colleagues a moment ago express the view that NAFTA played a significant role here. Likewise, with respect to the dollar, I think the peso yesterday reached the lowest point relative to the dollar since the crisis began in December.

Tell us what is happening here. Why is it that the international pledges of support have not succeeded in arresting the decline of the peso. What is happening here with regard to the linkage between the Mexican problem and the dollar, and what is the relationship between the Mexican problems and NAFTA.

Mr. SUMMERS. Congressman——

Mr. HAMILTON. In a couple of sentences please. [Laughter.]

Mr. SUMMERS. Congressman, as for the dollar, we have had a strong policy since the administration begun that I think you can understand that in light of the sensitivity of anything one says, that only the Treasury Secretary speaks on fluctuations in the dollar, and so I would refer you to his statement on Friday that a strong dollar is in our national interest, that we had acted toward that objective, and that the President was continuing to work on economic fundamentals, strengthening the economic fundamentals of our country including by working on the question of deficit reduction and beyond reiterating what I said before——

Mr. HAMILTON. Would the——

Mr. SUMMERS. About the Exchange Stabilization Fund not being fully available, the foreign currency reserves of the United States continuing to be fully available to defend the currency in the event that that became necessary.

I would not want to make any further statement on the dollar. I would be happy to address NAFTA.

Mr. HAMILTON. Mr. Secretary, I know you are not the Secretary of the Treasury, but the President the other day declined to make a comment on this. Yet there are a lot of very legitimate questions here.

Is this flight from the dollar that we see in the markets today mean that we are short of resources to defend its value? To what extent does the dollar's recent slide reflect concern in the financial markets that Mexico's headed for a recession that could severely impact the Mexican economy?

To what extent is there doubt out there that the United States does not have the resources to defend the dollar? To what extent is there worry about the United States becoming a lender of last resort to major developing and emerging economies?

It is not satisfactory for the President to say I am not going to get into that, for you to say that you are not going to get into it, and then to cite a statement from the Secretary of the Treasury that just says that a strong dollar is in the American national interest. Of course, it is in the American national interest.

Can't we get something more on this?

Mr. SUMMERS. Congressman, I understand your concern. I do not feel that it is appropriate for me to make market commentary about the factors effecting the dollar.

Mr. HAMILTON. Perhaps you could convey——

Mr. SUMMERS. At time when the——

Mr. HAMILTON. To the Secretary and to the President, and I think I am not expressing just my concerns——

Mr. SUMMERS. I have——

Mr. HAMILTON. I think I am expressing concerns of a lot of people here.

Mr. SUMMERS. At a time when the market is open, I will certainly convey your concern, and I will reiterate the point that I have made.

Mr. HAMILTON. I understand, I understand.

Mr. SUMMERS. That there is no respect in which the capacity of the United States to mobilize its foreign currency reserves, its marks, its yen, its foreign currency reserves to defend the dollar has in any way been diminished by what has taken place.

And so that concern is not a valid one.

Chairman GILMAN. Mr. Summers, Mr. Summers——

Mr. SUMMERS. I think you can understand——

Mr. HAMILTON. Even on that point, the Economic Stabilization Fund, which has been used for similar purposes for a long time, you are using an enormous proportion of it for Mexico. And so for you to say that the use of the ESF for Mexico does not in any way diminish the capacity of the United States to defend the dollar does not seem quite reasonable to me, because in fact, you are using a very major asset that we have constantly used to defend the dollar, and you are depleting its resources.

Why would that not diminish the capacity of the United States to defend the dollar?

Mr. SUMMERS. Congressman, to fully answer that question, I would have to get slightly technical, but let me just say that the $20 billion, approximately $20 billion of marks and yen that we have can be, will be placed with the Federal Reserve in a swap for dollars.

If we need to—if in the event that that becomes necessary in order to mobilize dollars to lend to Mexico. Those marks and yen

will still be available because that swap can be reversed in the event that we need to use them to purchase dollars.

All of the marks and yen United States has that are potentially available to purchase dollars will still be available for the purpose of purchasing dollars.

Mr. HAMILTON. Let me, let me——

Mr. SUMMERS. It may help, it may help if I may remark——

Mr. HAMILTON. Let me make clear to you, Mr. Summers, that I am not asking you here to tell us what your plan is for the dollar. I understand the sensitivity of that.

What I am trying to understand is, what are the factors that are hammering at the dollar today. I do not understand why the dollar is dropping like it is, and that is what I am trying to get at.

I also want you to answer the question about NAFTA.

Mr. SUMMERS. I appreciate your concern, Congressman, and I hope you recognize that it has been the practice that U.S. financial officials do not attempt to provide analysis on the reasons for particular market movements on particular days, but I will certainly convey your concern.

I think that NAFTA is not, I think it is not plausible to suggest that NAFTA is the cause of the problem that we have experienced in Mexico. Indeed, one of the important virtues of NAFTA that was cited by its proponents was that it would lock in certain reforms that were taking place in Mexico.

I think we saw that virtue when certain Mexican tariffs were increased last week in a context of Mexico's response to the current crisis, but of course, the tariffs on American products that had been lowered in the context of NAFTA were not increased.

NAFTA, I think, provides important insurance that whatever happens as this crisis unfolds, a variety of essential protections that it provided for American exporters to Mexico, and American economic interests in Mexico, would continue to be in place and could not be reversed.

I think NAFTA is a source of what is very much needed in a situation of this kind which is confidence.

Fundamentally, Mexico's situation in my judgment is like that of a company that was rapidly improving in its productivity, it was producing increasing quality products, it was producing them in more and more efficient ways. It was innovating successfully, but had badly over-leveraged itself and got into trouble.

NAFTA addressed those structural elements in the Mexican economy and I think served to reinforce them in a helpful way. The problem came because of the financial policies and how those financial policies played out in a political context during 1994 where I think we can all agree that there were a wide variety of shocks of a kind that were quite unexpected.

Mr. HAMILTON. Thank you, Mr. Chairman.

Chairman GILMAN. Thank you, Mr. Hamilton. Mr. Rohrabacher.

Mr. ROHRABACHER. Mr. Summers, according to your testimony then, only $3 billion have actually been disbursed, as you say, so up until this time only $3 billion of taxpayers' money has actually gone to this end, in bailing out Mexico's economic situation.

Mr. SUMMERS. That is correct, $1½ billion from the Treasury, and $1½ billion from the Federal Reserve.

Mr. ROHRABACHER. OK. I would like every one of my colleagues to note that, that there has only been $3 billion now, and so if we act very quickly, we could stop the rest of that, is that correct?

Mr. SUMMERS. Secretary Rubin has, and more accurately the Treasury Department issued a statement yesterday in which it indicated that it was our intention to go ahead with this program——

Mr. ROHRABACHER. Right.

Mr. SUMMERS. Because we felt that——

Mr. ROHRABACHER. Certainly not if Congress acted to tell you not to do that. You certainly would not——

Mr. SUMMERS. Certainly we will always, certainly the administration will always act within the law.

Mr. ROHRABACHER. OK, but would act against the approval of Congress if Congress passes a disapproval.

Mr. SUMMERS. The administration—I am not in an attorney.

Mr. ROHRABACHER. Let me——

Mr. SUMMERS. I am sure that the administration's actions will be fully consistent with the law.

Mr. ROHRABACHER. Well, I am very happy to hear that——

Mr. SUMMERS. Fully consistent with the law, and the administration will make——

Mr. ROHRABACHER. I am sure that helps us. That really makes us feel very good that you are going to make sure that within the law——

Mr. SUMMERS. Congressman——

Mr. ROHRABACHER. Even if Congress disapproves of this policy. The fact that you had to go and do this without congressional approval does suggest that maybe you think Congress does not approve of sending tens, or making tens of billions of dollars available for this.

Let me ask about this swap, this $20 billion swap that you are talking about here which appears to me to be one of the shell games of you can get something for nothing.

I tell you, when anybody ever comes to me and tells me I can get great benefit out of taking, and there is no risk and it is not going to cost me anything, I will tell you, that person is someone I want to scrutinize very well, and if anybody believes that, I have said this before, we have some bonds in Orange County we would like to sell you because you do not get something for nothing.

To reverse the swap that you talked about which supposedly has very little risk and so much benefit, to buy back the marks and Swiss francs that have been put up, where do those dollars come from to reverse the swap?

Mr. SUMMERS. The swap that I was referring to was a swap that would take place between the Treasury and the Federal Reserve.

Mr. ROHRABACHER. That is correct.

Mr. SUMMERS. And so if the Treasury——

Chairman GILMAN. Mr. Summers, could you move the mike a little closer?

Mr. SUMMERS. Excuse me. Was a swap that would take place between the Treasury and the Federal Reserve, and so in the event that the Treasury swapped foreign currency to the Federal Reserve, the Federal Reserve would swap dollars to the Treasury.

In the event the Treasury needed to get back access to its foreign currency, it would swap dollars back to the Federal Reserve.

Mr. ROHRABACHER. Where would those dollars come from?

Mr. SUMMERS. The dollars would come from the existing stabilization fund at the Federal Reserve.

Mr. ROHRABACHER. Ah, ah. So it would come from—there is some expenditure of U.S. dollars here. It is not just something that is going to happen and so in fact, to reverse the process, we are talking about spending tens of billions of U.S. dollars, is not that correct? If this swap does not work and we have to reverse the swap?

Mr. SUMMERS. Congressman, there are two different swaps and I am not sure which one you are referring to. There is the possibility of a swap between the United States and Mexico. There is also a swap between the Treasury Department and the Federal Reserve. I am not sure which one you were referring to.

Mr. ROHRABACHER. There are swaps dealing with other currencies that are attacking the stability of the Mexican peso, and we are supposedly going to use that money, our own currency that we hold, to protect the peso against attacks from that direction.

Now, in the end, if that does not work, we end up having to trade U.S. dollars for those French francs and those German marks or Japanese yen, isn't that correct?

Mr. SUMMERS. Congressman, I am afraid I do not recognize the arrangement as I understand it.

Mr. ROHRABACHER. All right. Well, I do not think the American people understand this either, but I do think the American people understand that they are putting, they are being put in jeopardy in some way, and that you cannot get something for nothing.

With the chairman's indulgence, I just would like to continue just one more moment.

Chairman GILMAN. Please proceed.

Mr. ROHRABACHER. We have today the AP and this is a story out of London, the dollar sank today to new lows against the Japanese yen, and continued to fall against the German mark and other key currencies in European trading.

We have another story here in the *Los Angeles Times* talking about the economy: "Dollar sinks". And then it says here widespread anxiety over U.S. rescue plan for Mexico, a commitment that has been interpreted by some traders as limiting the Clinton administration's ability to protect its own currency with large purchases if necessary.

Now, I take it for granted that the people who are dealing in international currencies actually understand this better than I do. I am a former journalist, and I really do not totally understand this all, but I have a feeling that these people who understand, who make currency trading their lives are giving the American people a message, and that is your leaders have put you in jeopardy.

Is there some other interpretation of why our dollar is sinking right now?

Mr. SUMMERS. Congressman, as I suggested in answer to Congressman Hamilton's question, I am not able in this forum to engage in market analysis with respect to the dollar.

What I can assure you is that as Secretary Rubin has stated, and Chairman Greenspan has stated on repeated occasions, based on

their extensive analysis and their extensive experience in financial markets, that the capacity of the United States to intervene in defense of the dollar is not in any way diminished by what has taken place.

Mr. ROHRABACHER. So far.

Mr. SUMMERS. That all——

Mr. ROHRABACHER. With $3 billion, I think that is correct but if we end up spending $20 billion out of that fund, I think the international markets are beginning to tell us that they do not see that that stability is there.

Mr. Summers, we have had 12 years of stability in terms of the U.S. currency. It has been our greatest strength. It has permitted our people to prosper, and the standard of living of our people to improve.

I believe what you are doing, what this administration has done is put that in jeopardy in the worst possible way, and the beneficiaries are going to be international speculators, and are going to be basically Wall Street speculators who went down to Mexico, and now we are having to bail them out.

I think this is outrageous. I am sorry. I know you are a very sincere man. You have been caught in a bad position but the fact is, wrong decisions have been made.

Chairman GILMAN. The gentleman's time has expired.

Mr. ROHRABACHER. Mr. Chairman——

Chairman GILMAN. Mr. Menendez.

Mr. ROHRABACHER. Mr. Summers should be able to answer that.

Chairman GILMAN. A very brief response please.

Mr. SUMMERS. Just so that I am clear, it was the judgment of Chairman Greenspan and Secretary Rubin that even in the event that we were to provide the full extent of the swaps, or guarantees to Mexico, that the capacity of the United States to intervene in defense of our currency would not in any way be interfered with.

That is not simply a judgment based on the amount that has been extended so far.

Chairman GILMAN. Mr. Menendez.

Mr. MENENDEZ. Thank you, Mr. Chairman. Under Secretary Summers, let me just say that what I have heard today, and I read—I had to step out for a bit, but I read your written statement—does not assuage my concerns in this regard, and I am going to ask a series of questions. I would like to lay it out for you, since my time is limited, and see if you can respond to them at the end.

According to a recent article by Douglas Payne in the *New Republic,* in April of last year, a group named the Westo Forum which is organized by the Westo Group, organized two meetings with Mexican Central Bank officials, and with Guillermo Ortiz who now is Mexico's finance secretary, and then was its under secretary.

In their meetings, this group gave Mexican officials "policy suggestions" aimed at preventing a gradual peso devaluation at a time when it would have been prudent to do so.

And according to the report, the group further pressured the Mexican Government into adopting its suggestions by refusing to buy enough short-term peso denominated cetes to replace existing

ones, and that caused Mexican interest rates to shoot up, and the stock market to plunge.

Now, the Mexican Government then relied on dollar-denominated tesobono debt which is exactly what the Westo Forum wanted, and which the U.S. support package seeks to repay. The group's head, John, I think it is Liegey, the president of the Westo Group, told the *Wall Street Journal* reporter that, "We have gotten a good portion of what we wanted from the Mexicans."

Now, at a time when a young man just brought down one of England's oldest investment houses, I ask you what can be done to control these pressure-type of activities which call for short-term gains for a few Wall Street investment firms, but which in the end has caused severe long-term losses for everyone?

What can be done to prevent the promotion of a speculative environment? And this is what many of us have been concerned about. I know I have raised this question at every hearing that we have had, including in the Subcommittee of the Western Hemisphere, in which the American and Mexican people are lead to believe that the situation such as Mexico's during the last 2 years is entirely different than what it is.

This is an emerging market and we are participating in creating a speculative environment in emerging markets which mom and pop investors, the bread and butter to a large degree of Wall Street investors through pension funds and market funds, middle America, in fact, have at risk investments in places such as in Mexico in terms of emerging markets.

So I would like to hear, I guess that is one example of I am sure many, what is it that we are prepared to do to have learned from this lesson in this regard? How do we stop that speculative environment?

Two, given the events that have further deteriorated in Mexico in the last 2 weeks, would you tell the committee which economic goals outlined by the Mexican Government to the International Monetary Fund and to the United States will the Mexican Government be able to meet?

I am concerned. I would like to know whether the projected economic growth in 1995 in the agreement, the Mexican Government says that it will grow at the rate of 1.5 percent in 1995.

I would like to hear your view on inflation. The government claims that it can limit inflation to 19 percent annual rate. Is that reasonable?

The external current account deficit, the government seeks to limit it to 14 percent for the year and is that realistic?

Wages for Mexican workers: they want to limit it to 7 percent. Is that feasible?

And lastly, this *Wall Street Journal* article that appeared on February 25 says a poll conducted by the newspaper *Reforma* found that of 200 small and mid-sized businesses surveyed last week, 35 percent had let its staff go. The problems for employees at these small companies could worsen quickly too.

Fifty-six percent of the companies said they were in danger of going out of business, and 68 percent did not have a plan for coping with the crisis.

All of that gives me, as well as my constituents, a great deal of insecurity, and I have heard nothing today to assuage me. Would you please respond?

Mr. SUMMERS. Congressman, you have raised a significant number of concerns, and I see the yellow light. My time is short.

I would say that one of the reasons that the——

Mr. MENENDEZ. That was my time. Now it is your time.

Mr. SUMMERS. One of the reasons that President Clinton asked for this review of the international financial architecture in the context of the Halifax summit was precisely because of his concerns about this new world where money moves as rapidly as it does, and what the potential consequences of that can be.

I expect that those discussions will focus on the question of what kinds of steps can be taken through information policy, through surveillance, through disclosure, to prevent future Mexican crisis from coming to pass, and what kind of response can be taken to minimize the costs and the burdens in the event that those crises are to take place.

The Mexican Government, as I have said in my testimony, received warnings from American officials with increasing urgency through the passage of last year that the policy path that they were on could prove to be unsustainable, and that some adjustment was appropriate.

As I have suggested, while they had access to very similar information, to the information American authorities had, many, many of the participants in the market and the commentators felt that Mexico's path was a sound one, and encouraged Mexico to continue down that path, and that may have been one of the contributing factors in the decision of the Mexican authorities not to heed the warnings that American officials provided.

I think we would be in a very different environment going forward because of the conditions attached to this support program. Of course, last year, the United States was not a creditor of Mexico.

I expect that Mexico will meet the policy commitments in terms of the budget deficits, in terms of control on the growth rate of money, in terms of carrying through on privatization they have made in the context of its IMF agreement.

Clearly time has passed and the economic situation has changed since the forecasts that you referred to were made, and I expect that at some point, Mexican authorities and the IMF will revise those forecasts to reflect economic situations.

I would note that——

Mr. MENENDEZ. Excuse me, by revising it, you are suggesting that it may change to less than anticipated.

Mr. SUMMERS. Well, I expect the current account deficit will be less than anticipated, and that the adjustment of the current account will be larger than was anticipated, and I would expect that there may be, when the next forecast is issued, adjustments of the inflation forecast and adjustments with respect to some of the other variables that you referred to.

I think the important thing is the policy commitments that the Mexican authorities entered into, and they have made clear that they intend to live by those policy commitments in terms of tight money, in terms of taking the steps necessary to have tight fiscal

policy to continue privatization, and to reduce reliance on foreign capital.

Chairman GILMAN. The gentleman's time has expired. Mr. Salmon.

Mr. SALMON. Thank you, Mr. Chairman. Mr. Summers, I have a couple of questions. There are other economies that are having problems stabilizing their currency as well. Just to mention a few—Brazil, Turkey, Russia. My question to you would be where are we going to draw the line?

Each and every one of those nations' economies are vital I think to the world trade scenario, and are we going to commit U.S. dollars to those countries as well to prop up their currency? Are we going to draw any line, or is this just the beginning?

Mr. SUMMERS. I think Secretary Rubin in his statements before the Congress has made clear the very special nature of the Mexican situation, that it is very special because of the 2,000 mile border we share, that it is very special because Mexico has occupied a somewhat unique position as a kind of exemplar to other emerging market countries, and so an effort of this kind by the United States would not in general be possible in the case of future problems that might arise.

And that is why a more institutional response, particularly to preventing these problems, but also to addressing them, if they happen, through the international financial institutions, has seemed to us appropriate, and that is why we have put such emphasis on that question in the context of the upcoming review of the institutions as we move toward Halifax.

Mr. SALMON. So you are basically saying that Brazil, even though it has a significant importance to Latin America, Turkey whose economy is very important to that part of the world, and Russia who obviously we have a vested interest in ensuring that they achieve the type of not only economic but political reforms that we are hoping that they achieve, you are saying that those pale in comparison in to the circumstances of Mexico.

Mr. SUMMERS. I am saying that it has been the policy statements of the administration that Mexico event, and the Mexico——

Chairman GILMAN. Mr. Summers, could you speak into the microphone?

Mr. SUMMERS. The Mexico event and the Mexico policy response is something extraordinary, and that we would be working to address problem that may arise in the future in other countries, not to ignore them in any way, but to work to address them through the international financial institutions.

Mr. SALMON. Have any of the losses by American corporations to date that have speculated in Mexico, have any of those been compensated for or made whole with any of the $3 billion that we have cut loose so far?

In other words, have any of the coffers been replenished by those American corporations that lost due to speculation in Mexico, has any of the dollars found their way to those corporations?

Mr. SUMMERS. Certainly Congressman, the U.S. Treasury has not made any direct payments to——

Mr. SALMON. I know that, that they would not make direct payments.

Mr. SUMMERS. That any——

Mr. SALMON. But through Mexico, or those that have deal with——

Mr. SUMMERS. Mexican authorities have used a portion of these resources to repurchase some of the desa bonos that are outstanding in the—to repurchase some of the desa bonos that are outstanding in the marketplace.

I think the support we have provided has provided more confidence in Mexico than there otherwise would have been, and in that way has contributed to the financial environment in Mexico, and of course, there have been many beneficiaries of that.

Mr. SALMON. So——

Mr. SUMMERS. The reason we provided the support was to protect the American interests that I have stressed——

Mr. SALMON. So what——

Mr. SUMMERS. Jobs, immigrants, our national security.

Mr. SALMON. Specifically what corporations have benefited then? Do you have a list?

Mr. SUMMERS. No, I do not because the—I do not have any kind of list, nor would it be possible to prepare such a list because corporations have benefited only insofar as they have benefited from a general improvement in economic conditions in Mexico, not because any of this has been channeled to any specific entities.

It has been the general community that benefits from the Mexican, from an improved economy in Mexico.

Mr. SALMON. So no corporations specifically have received any dollars through Mexico. It has just been more of a general——

Mr. SUMMERS. That is correct.

Mr. SALMON. Everybody feels better about the country, and everybody feels better about investing.

Mr. SUMMERS. That is correct.

Mr. SALMON. OK, one last question. It has been described in many terms, this collateral, so-called collateral or guarantee through the oil reserve fund. From a layperson's point of view, that is what I am going to call it. You can maybe describe that in more technical terms if you would like, but it is my understanding that the way that fund works is that it is constantly fluid—money comes in, money goes out, money comes in, money goes out.

If I were to go and try to secure a loan from a bank and put up as collateral a fund, let us say that I had $100 in, and my explanation to the bank was I will spend down that $100, either all of it or any portion thereof, but I will constantly replenish it, but that is my collateral.

Do you really believe that there is any bank in this country that would grant me a loan based on that kind of collateral? And if I am not understanding how that fund works correctly, maybe you can explain to me how that fund does work.

Mr. SUMMERS. Congressman, the fund works by giving, or the mechanism works by giving the United States the right to access Mexico's oil export revenues, the entire stream of oil export revenues, in the event of a default.

So it might in some ways be like somebody who lent money to a real estate investor, getting access to all of the lease payments

that that real estate investor received going forward in the event of a default.

We have access to a revenue stream in the event of a default, and that access is based on irrevocable instruction, that is instructions that the Mexican Government gives to the customers for their oil, that by law, cannot be revoked by the Mexican Government down the road.

I think that type of security arrangement is actually a security arrangement that is rather stronger than agreements that are quite commonly entered into by commercial institutions in this country.

Chairman GILMAN. The gentleman's time has expired. Mr. Berman.

Mr. BERMAN. Well, thank you, Mr. Chairman. Secretary Tarnoff, are you having fun? I would like to hear more about the swaps. No, I am just kidding. I do not understand those.

The New Republic on February 27, 1995, a different I guess article than Mr. Menendez was referring to, sort of did a critique of the administration's decision. I do not know if you saw it, but it stated that the impact on our economy of whatever happened, even an economic catastrophe in Mexico would not be that great, and while there might be some humanitarian or political reasons to do something, $50 billion was far more than was needed. You would only do that if the global financial system were on the verge of collapse.

It points out that the relative stability of the stock markets in New York and London and Tokyo shows that this really was not as serious as we were lead to believe, and then they ask this question, and I guess I would like your comment on these two paragraphs. I will just take a moment's time to read them.

What was the alternative to the Mexico bailout? The obvious answer was to allow Mexico and its private sector creditors to work out a deal among themselves. After all, they got themselves into the mess, if Mexico's economy is fundamentally sound as the U.S. Treasury claims, and the problem was a short-term liquidity crisis, it ought to have been soluble without a massive injection of public sector loans and guarantees.

With a default looming, there must have been terms on which investors would have agreed to lengthen the maturity of Mexico's short-term debt. I believe that happened in the debt crisis of the early 1980's. I heard Mr. Rohrabacher earlier talk about 12 years of great stability, but I remember some less than great, highly stable times during those past 12 years.

But any collateral, the article goes on to say, that could be offered to taxpayers such as the rights to the future oil revenues, could also be offered to private investors.

It then ends with the fundamental question raised by the Mexican crisis is whether global investors are to be treated as adults or children. Are they to be responsible or not? We are supposedly entering a brave new world of global capitalism. Economic development is being powered by market forces, rather than the financial largesse of finance ministers and multilateral agencies.

After decades of paternalistic constraints, the pattern of growth is increasingly determined by the financial decisions of independent

private sector investors all seeking high returns. These are desirable of long overdue changes, but they will not lead to greater prosperity if the market's safety mechanisms are repeatedly overridden.

Countries have to pay a price for imprudent policies. Individuals have to pay a price for rash investments. The problem with bailouts is they reward irresponsibility, and so make future crises more likely.

Mr. SUMMERS. Congressman, I think that you and that article raise absolutely critical questions, and they are questions that we in the administration in conjunction with the Federal Reserve spent a great deal of time thinking about before deciding that the policy that was in the best interests of the United States was the policy on which we embarked.

The situation in a conventional commercial situation when a company goes bankrupt, is as that article suggests, that the creditors provide some continuing finance, and an arrangement is made through the bankruptcy mechanism.

In 1982, during the debt crisis, something similar took place, although there was no bankruptcy mechanism. Because there were a relatively small number of large creditors—basically the major banks, and the major banks in conjunction with the foreign governments, in consultation with the official sector, were able to work out an arrangement that restructured and rescheduled the debts in order that the liquidity crisis was averted.

One feature of the new financial landscape is that instead of the creditors being a few major institutions, the creditors are literally thousands of disbursed investors who are not possible to bring together, and through which there is no legal mechanism to get them to accept the kind of subordination and stretch-out that is possible in the event of a commercial bankruptcy.

And it is for that reason that it was the judgment of the U.S. Government that simply allowing the market to work this out would have catastrophic consequences in Mexico, and that those consequences would spread far beyond Mexico's borders, and would work very much to the detriment of American interests in terms of jobs, in terms of immigration, in terms of the kind of model of market-oriented development that we were seeking to promote.

The consideration that you raised having to do with the fact that investors benefit, and that that may encourage irresponsibility in the future was, I think, a very, very real concern in our discussions.

Of course, most of those who have invested money in Mexico over the last, in the course of 1994, have found that to be a quite expensive investment.

But the fact that some would benefit, and the moral hazard consideration that would result was a very real concern. This is a situation that financial authorities confront whenever the government acts to prevent a major bank from failing, or acts at the time of a major stock market dislocation such as it did to provide liquidity such as we did, that the beneficials did in 1987, but did not in 1929, they benefit certain investors, and that does discourage market responses that one wants.

However, the provision of that liquidity also averts what could otherwise be a catastrophic situation. A balance has to be struck,

and a judgment of the senior officials of the President and senior officials which was joined in by the congressional leaders was that the risks associated with not acting were too large to be acceptable, and therefore that the alternative that was pursued was while not a highly satisfactory one, was the best available alternative in the circumstances, and that is why we acted in the way that we did.

Chairman GILMAN. The gentleman's time has expired. Ms. Ros-Lehtinen.

Ms. ROS-LEHTINEN. Thank you very much, Mr. Chairman. Good afternoon, gentlemen. Secretary Tarnoff, I had a question for you related to your statement as it regards to Mexico and their relationship with Cuba. Somehow you knew I was going to ask you, did not you?

And you say in your statement the Government of Mexico's policy is not to provide assistance to the Government of Cuba, and it seems that historically the policy of the Mexican Government is exactly that, to provide assistance to the Government of Cuba.

As all of us know, there is no private businesses in Cuba. There is no private ownership. Castro is the government. He is the hardware store, he is the gas station. He is Cuba as the way that he runs it, and the Government of Mexico seems to me, from every indication for many years, has had a policy of stimulating trade, of having a positive economic relationship with Cuba, or encouraging the Mexican businessmen to go to Cuba and invest, and to give such a blanket absolution as I believe your statement gives, saying that the Government of Mexico's policy is not to provide assistance to the Government of Cuba, I think is quite a stretch.

There have been reports of Mexican investment in the Cuban phone system, in the Cuban electricity, and in every aspect of Cuban life, and if there are no more contracts, it is merely because Castro has decided not to take it even further, but to say that there has been—and also the debt for equity swaps between Mexico and Cuba—it just seems that this statement goes so far, and the evidence points so clearly to the other direction, that I would like to ask you about the proof that you have that this is the case.

And when you say the U.S. has no evidence that this is not the case, I would like to send the information that we have received throughout the years, and perhaps we can have further conversations about this issue.

But if you could comment on whether you truly believe that the Government of Mexico's policy is not to provide assistance to the Government of Cuba.

Mr. TARNOFF. Let me clarify that part of my statement in an effort to at least make somewhat more apparent what I meant by that term.

I used the term assistance in the sense of Mexican Government funds that would be part of an official development program. Mexico does not have very much foreign assistance, although there is a limited program of foreign assistance that Mexico does disburse to the so-called San Jose countries, primarily in Central America and the Caribbean.

The Mexican Government has assured us, and we believe on the basis of our own queries and information, that there is no Mexican

Government money in the form of governmental assistance going from Mexico to Cuba.

Now, this said, and my statement I hope reflects it, you are absolutely right, that the Mexican Government does encourage private Mexican businessmen to become involved in Cuba. They do it because they perceive some financial gain, and they also do it as part of an overall approach to Cuba which I said in my statement we disagree with, and that is to afford opportunities to Cubans, many of whom, most of whom have an official capacity in Cuba, to develop their economy in the hope, according to Mexico, that this economic activity will generate an opening to reform, a susceptibility to influence any reform direction.

We do not believe that this is an appropriate tactic. As again I said in my statement, we believe that isolation, increased pressure on the Cuban Government is the appropriate way to proceed, but on your specific question, I was referring to official Mexican Government credits when I used the term assistance.

Ms. ROS-LEHTINEN. Thank you, Mr. Secretary, and we will follow up with you. Thank you.

Chairman GILMAN. The gentlelady's time has expired, and I thank the gentlelady for raising these important issues on Cuba, and I will ask our witnesses to respond in writing to these and other questions that our committee members may have with regard to Cuba.

Mr. Engel.

Mr. ENGEL. Thank you, Mr. Chairman. Mr. Tarnoff, I want to start by asking a series of questions about NAFTA. In particular, does not Mexico's crisis vindicate NAFTA critics who pointed to the risks of free trade between countries at varying levels of development?

What should be the lessons of Mexico for future free trade agreements, and has this effected the administration's plans for Western Hemisphere free trade negotiations?

Mr. TARNOFF. Congressman, let me respond to at least the political side of that question. It is political as well as economic, and ask my colleague, Under Secretary Summers, to respond to the substantial economic component of your question.

We believe that on the political side, the opportunity for the United States to engage and cooperate with Mexico in the context of the NAFTA agreement was unprecedented and basically very positive for us in terms of being able to deal with the country, as many have said here, which is not only a neighbor of the United States, a major trading partner of the United States, but with almost 100 million people not across the ocean, but at our border.

We also believe on the political side that in the context of the developing relationship that we have built with Mexico, especially since the passage of NAFTA, we have more of a—we have more by way of information from the Mexicans about their own intentions despite the very unsettling events of recent weeks and months.

The degree of political reform, the degree of openness in Mexican society, the degree of transparency in the Mexican political process is absolutely unprecedented. As I said in my opening statement, this will be a rocky road. There will be reverses for many years to come, but the fact that President Zedillo can commit himself to this

degree of openness, not only with respect to the political system, but by confiding the responsibility for the judicial oversight of his government to a member of the opposition is again, in terms of Mexican development and development throughout much of Latin America, absolutely unprecedented.

So speaking again primarily in my own area of interest, the political side, we believe that the engagement that NAFTA brought about is a powerful incentive for the Mexican Government to continue the reform along these lines.

Now I might ask Under Secretary Summers to comment on the more strictly economic dimensions of your question.

Mr. SUMMERS. I would just emphasize that the NAFTA agreement had its principal effect on economic policy in Mexico, that it removes——

Chairman GILMAN. Would you please speak closer to your microphone?

Mr. SUMMERS. It removed a whole set of trade barriers in place in Mexico to foreign products, particularly to American products, and that it served to lock in a variety of reforms in Mexico that are very much in the interest of U.S. exporters, and the importance of that locking in and protection of American economic interests, I believe, is confirmed by the events that have taken place recently.

I think without trying to recarry out the NAFTA debate, it is worth remembering that the reductions in trade barriers in Mexico to American products that took place was a far, far larger reduction in trade barriers than anything that took place with respect to American barriers to Mexican products, and so in that way, NAFTA was very, very much of a win for the United States.

Mr. ENGEL. Let me ask you, Mr. Summers, what role did NAFTA play in causing Mexico's financial crisis? Did the market opening required by NAFTA have a bigger impact than we expected on Mexico's current account balance?

And also a very, very important question I think, did Mexico postpone the devaluation of the peso in order to make it seem a more attractive export market in the run-up to the U.S. vote on NAFTA?

Mr. SUMMERS. I do not think NAFTA was a consequential factor in Mexico's devaluation. Indeed, by providing an extra source of confidence, I think it was a source of support and stability in the Mexican economy.

I am not aware that any political calculus with respect to American politics entered into the thinking of Mexican officials in determining their economic policies, though of course, I would not feel that I could in any way reach a conclusive judgment about the thinking in the inner sanctums of another country's government, but that is to my knowledge a factor that entered in during 1993.

Chairman GILMAN. The gentleman's time has expired. Mr. Payne?

Mr. PAYNE. Thank you very much, Mr. Chairman, Mr. Summers, Mr. Tarnoff. Of course, we realize that the administration in many of our opinion had to take a very difficult decision. I think it is like a glass being half empty or half full. If you did not put the bailout out, what would happen, or if you do put the bailout, what would happen, and I think that as we have heard, there has been half a

dozen on both sides, and therefore, this is a very difficult decision made by the administration.

Of course, it was done unilaterally by the administration because of the lack of support in the Congress, and it creates a number of problems, and I am certainly not totally criticizing the President. I would not have wanted to make that decision, so for one time in my life, I am glad I am not the President.

But let me just say that with the discussions going on—well, the fact that there has been a decision made to assist in the bailout, there were a number of issues, and we do not want to relive NAFTA, whether it was right or wrong—of course, I opposed NAFTA from the beginning—but there are a number of issues that seemed unresolved at the time that NAFTA was agreed, and not that we should do unjust coercion, but if we are putting this line up to possibly $40 billion for the bailout, it would appear to me that some of the unresolved issues of NAFTA—for example, my good friend from Labor, Owen Beaver and some of the other labor leaders, have a concern about the fact that Mexican workers have a cap on increase in wages, although inflation goes up.

There is a feeling that wages should be, you know, tied to productivity. There are side agreements that have been reached by both countries which are not moving along as we thought that they should.

There is some question about the displaced U.S. workers and whether the administration is doing enough to assist in their plight. There is a concern about reform being made in the capital markets. The fact that democratic reforms have not been carried out, and the position especially of the peasant is extremely important, it is not in any better shape today than it was 5 years ago, and there seems to be nothing moving in the direction to improve that.

I guess my question, and also on the side of industry, we have gotten concerns from industry in my state such as AFG Industries, which manufactures and produces glass, and there is an export tariff of 20 percent to Mexico, but Mexico has no, there is no tariff on Mexican glass, and there are a number of duty reduction negotiations that were supposed to be going on to accelerate the reduction of tariffs on U.S. products to Mexico which has been given a 10-year window, but seems to be going slow.

My question is simply this, have we looked at renegotiating or pressuring or encouraging the Mexican Government to do the right thing in these instances that I brought out, or is that any, is that a part of the continued support for the bailout?

Mr. SUMMERS. Congressman, the agreement that was signed by Secretary Rubin and Mr. Ortiz on February 21 was a purely commercial agreement addressing financial aspects.

I think, and this may be something that Under Secretary Tarnoff can speak to, that the circumstances we now find ourselves in represent a fundamental change in U.S./Mexico relations, and will permit the United States over time to pursue more actively a whole range of concerns on a whole range of bilateral issues with respect to Mexico, and I am sure that list will include some of the ones that you have raised.

Mr. TARNOFF. I could, Congressman, just add a word to what Under Secretary Summers has said, and that is to first of all, affirm that it will not be the position of this administration to seek to revise or renegotiate any of the terms of NAFTA.

However, we believe that the NAFTA agreement, including some of the mechanisms that have been set up under that agreement, a couple of which I referred to in my testimony, in my prepared remarks, give us the opportunities to engage very actively with the Mexican Government in a wide variety of ways through various committees and working groups.

The purpose of these mechanism was to allow the United States to work with Mexico, and Canada, I might add, on many of the problems that you raised, and insofar as there are complications or deficiencies that come to our attention, we will certainly do so.

Mr. PAYNE. I just wanted to make it clear, Mr. Chairman, that as you indicated, I am not advocating renegotiating of NAFTA. I opposed it when it was on the fast track with the other administration, and opposed it under the current administration, but there are principles that were set forth—for example, the promised accelerated duty reductions. That is a part of NAFTA.

We just think that maybe this is a good opportunity to accelerate the reduction of duty on U.S products, to take advantage of the agreement, but simply to accelerate it, and those other points that I raised about some of the labor concerns which are part—the environment—these are part, as you know better than I, since you were probably involved in the negotiations and the writing of the agreement—these are things that are currently in the agreement. I am simply saying that perhaps while we are dealing with the bailout, it may be an opportunity to move toward the goals that are set out in the agreement.

Thank you, Mr. Chairman.

Chairman GILMAN. The gentleman's time has expired. Mr. Brown, the gentleman from Ohio.

Mr. BROWN. Thank you, Mr. Chairman. I would reiterate quickly what my friend from New Jersey just said, that now is our opportunity. NAFTA was one opportunity. We blew that chance. This is our second opportunity to deal with some of the problems that the Mexican Government, some of the tragic things the Mexican Government has done to its people in terms of keeping wages down, in terms of democratic, the totalitarian abuses, in terms of environmental laws, in terms of worker safety laws, in terms of wages—all of those kinds of things.

The Mexican people have suffered because of the totalitarian regime, and I think, Mr. Chairman, that it makes sense because we do not have—we had a hammer with NAFTA to get some of those things worked out, and we failed for a lot of reasons. We have the hammer now to work those things out. If the administration wants to stick only very narrowly to economic issues of oil receipts and guarantees and that sort of thing, I think we are not addressing the fundamental problems, underlying problems that created the situation with the peso devaluation and the economic problems in Mexico, and I just would like to put in my views that I would hope that we would entertain some of those issues before we got into this situation a third time.

One quick question for Secretary Tarnoff. The Assistant Secretary Watson told this committee last year that the Zappatistas ZZLF was not a particularly serious threat.

The Zedillo administration, first they came down hard on him, and then they negotiated and they came down hard, and then they said they wanted to negotiate. What do we do as part of the bailout, but more importantly long-term as part of what our relationship with Mexico should be, with that whole situation?

What do we say to their government with the situation in Chiapas and the spreading particularly as economic problems worsen in Mexico? Where do we stand as a nation with the Zappatistas, and more precisely with Chiapas and those troubled regions and those potential revolutionary situations like that?

Mr. TARNOFF. I am not familiar specifically with what Assistant Secretary Watson said a year ago, but let me summarize briefly what our attitude is toward Chiapas and other potential movements of this sort in the country.

The Zedillo administration came in with a very clear policy of reconciliation in dealing with the EZLN in Chiapas. In January, for example, the Minister of the Interior of the Zedillo government met with a high ranking official of the EZLN and the Zedillo government made clear that it was its intention to try to move ahead the process of negotiation.

As you know, there had been a cease-fire in Chiapas for over a year, but there had been very little movement on the political front.

Nonetheless, in early February, the Mexican Government uncovered evidence which is now before the Courts and has been presented publicly to the Mexican people, that at least some elements in the EZLN leadership were planning to extend violence.

A small amount of weapons and explosives were found, and charges were brought against a dozen or so of the leaders of the EZLN.

At the same time, the Zedillo government announced that it wanted to, after securing the territory of Chiapas, wanted to reopen a dialogue with the people of the area. This very week, the Parliament, the Congress in Mexico has been convened in an extraordinary session by President Zedillo in order to address the issue of Chiapas of longer term reform, amnesty and ways for a policy of not only reconciliation but longer term development in Chiapas can take place.

Our basic approach to the issue in Chiapas or elsewhere in this kind of a situation is principally twofold. We recognize the necessity of governments to be able to exercise legal authority, make sure that law and order is guaranteed when there are threats to it, and when there are not, when they believe that transgressions have occurred, it is very important for the Mexican Government, and they know this from us in a variety of ways, to have these charges out in the open so that they can be handled in a judicial way.

At the same time, human rights of the people in Chiapas and elsewhere are elements of great concern to us. Mexico's own human rights commission has over the past 14 months conducted a series of investigations into the behavior of the army in Chiapas starting in January of 1994.

The commission has uncovered some abuses. Those abuses have been looked at, but in our view, not sufficiently investigated by the Government of Mexico, and we will continue to point out to the government that if they hope to achieve reconciliation and development of Chiapas, it has got to pursue both of these approaches simultaneously.

Chairman GILMAN. The gentleman's time has expired. We are joined by the distinguished chairman of the banking committee, Mr. Leach.

Mr. LEACH. Thank you, Mr. Chairman. Let me say there are two extraordinary bits of prospective news today. That is, when you have the Mexican peso at 7-to-1, that means the wealth of Mexico has really been cut in half, at least in relationship to the United States.

In addition, the U.S. dollar vis-a-vis the yen has dropped to the low 90's. This is a full 10 percent drop from every economists' judgment that was predicted just 6 or 8 weeks ago.

If you recall, in the *Wall Street Journal* surveys of economic predictions, there was not a single economist that predicted the dollar this year to be less than 100 to the yen.

That is in effect a 10 percent drop in the wealth of the United States vis-a-vis Japan. That 10 percent drop is probably greater in totality terms than the 100 percent drop in terms of the peso.

So I would ask Secretary Summers as an economist, do you believe that there is an inter-linkage of the peso problem and the dollar problem? And how is it that our Government is going to respond, and can you respond simply with intervention, given the fact that part of our resources are now obligated, and is intervention an appropriate response.

Second, isn't the better response for Congress to move in the direction, as its new leadership is suggesting, of restraining public sector spending, and reducing the deficit which is exactly what we are pressing upon the Mexicans?

And doesn't this dual dilemma of a peso fall, a dollar fall underscore the short and long-term need for this Congress to restrain itself, and move in what in effect are the prudential directions of the new leadership of Congress are advocating?

Mr. SUMMERS. Congressman, let me respond partially to the question that you have asked. As I had a chance to explain in a colloquy with Congressman Hamilton before you came in, we have had a policy from the beginning that only the Secretary of the Treasury speaks on foreign exchange matters at a time when the markets are open, so I do not feel able on this occasion to get into an analysis of the dollar situation.

I would though make two points. First, the capacity of the United States to defend the dollar through intervention is not diminished in any way by the actions that we have taken, or could take in connection with the program that the President and the congressional leadership announced with respect to Mexico.

All of the foreign currency reserves of the Treasury and the Federal Reserve will still be available for the purpose of defending the dollar through intervention if that is the policy choice of U.S. financial authorities.

Secretary Rubin issued a statement on the dollar on Friday in which he said that a strong dollar was in the interest of the United States. He emphasized that the administration was working to strengthen further the fundamentals of our economy including by working on fiscal deficit reduction.

I do not think there is any question that progress in reducing the deficit contributes to healthier economic fundamentals, and that that is what is ultimately important for currencies.

Chairman GILMAN. The gentleman's time has expired. I want to thank our panelists for appearing, and I request that the administration witnesses respond to this committee in writing to any additional questions our members may have on the Mexican economic plan.

I am submitting in full without objection, the statement by Marcy Kaptur of Ohio.

[The prepared statement of Ms. Kaptur appears in the appendix.[1]]

Chairman GILMAN. Thank you. The committee stands adjourned.

[Whereupon, at 12:31 p.m., the committee was adjourned.]

[1]EDITOR'S NOTE: Additional questions from the committee were submitted to the Department of the Treasury, but their responses were not received by the time of printing.

APPENDIX

James A. Leach

Mexico—What Conspiracy?

Secretary Rubin has no ethics conflict here.

The next election could turn on one foreign policy question: Who lost Mexico, and why?

The leading candidates include two separate Clinton administration Treasury departments—the Rubin Treasury, which was presented an unchosen crisis at an unwelcome time and forced to review a tableau of no-win options, and the Bentsen Treasury, which dithered while the Mexican central bank printed pesos.

Assessing the accountability for what may be a benchmark crisis of the new world order is important because abstract macroeconomic decisions of the nature involved hold real consequences for real people—in this case the American taxpayer as well as the Mexican public. Post mortem analyses feature a clash of divergent economic perspectives.

One camp of supply-side economists argues that Mexico's decision to devalue the peso should have been avoided at all costs. Establishment economists, on the other hand, suggest that Mexico should have adopted a floating or flexible exchange rate policy early in 1994 to shield its treasury from massive foreign exchange losses.

From either perspective, an election-year rationalization of Mexican economic policy is framed by a crunching Catch-22: Loose monetary controls doomed the fixed exchange rate regime, while prideful efforts to postpone the inevitable devaluation of the peso caused a multibillion-dollar squandering of Mexican assets.

The Salinas government's methodology of pumping up the money supply while issuing dollar-denominated debt and betting its foreign exchange reserves on a known weak hand makes the 1994 election the most expensive in the history of democracy.

For its part, the U.S. administration appears to have turned a blind eye or blinked before Mexican political expediency—perhaps out of a desire to influence the Mexican election, perhaps due to fear there might be political ramifications north of the border if destabilizing events were perceived to be caused by or associated with NAFTA or the Uruguay round of GATT, or perhaps because the administration simply didn't know about or realize the consequences of the Mexican central bank's determination to increase the peso supply at a greater clip than the Federal Reserve allowed the money supply to grow in the United States.

We have yet to see whether the administration's approach to stabilizing the Mexican economy will work. But to suggest, as some on Capitol Hill did last week, that Secretary Rubin has an ethics problem because he once headed Goldman Sachs, which under his stewardship extensively underwrote Mexican securities, is a correlation as compelling as the observation, based on TV imagery, that adobe houses cause earthquakes. Cause and effect must be properly sorted out, particularly when character issues are under review. So must questions of competence.

In a world where geo-economics may replace geo-politics as the driving force in international relations, it is crucial that our government have leaders who have relevant business and economic backgrounds. Secretary Rubin has appropriate experience, and upon entering public service, he went to scrupulous lengths to place his assets in trust and dissociate himself from his former company. In so doing, he sacrificed substantial private earnings to serve his country.

The irony is that during development of policy options over the past several months, it was widely understood that the secretary was one of the last in the Treasury to be convinced of the case for U.S. intervention and the first to insist on the placement of tough investment banking conditions on his former clients.

President Clinton's second secretary of the Treasury may be wrong in his assessment of the national interest or, with time, may find his policies vindicated. But there is no ethics conflict and above all, no "Rothschildian" conspiracy. A misplaced emphasis on motivations can only lead to misguided conclusions about policy.

In my view, the Clinton administration engaged in a complicity of silence in the 1994 macroeconomic heist of Mexican public resources. It is guilty not of foul play but of negligence for failing to understand and alert the American public to the fact that in 1995, responsibility for rescuing the Mexican economy could fall upon the American taxpayer.

The writer is a Republican representative from Iowa and chairman of the House Banking Committee.

PREPARED STATEMENT OF PETER TARNOFF
Under Secretary of State
before the
International Relations Committee
U.S. House of Representatives
Washington, D.C.
March 7, 1995

Thank you. Mr. Chairman, members of the Committee, I welcome the opportunity to be here with you today to discuss our relations with Mexico.

The United States has fundamental national interests, both economic and political, in a stable and prosperous Mexico.

First, what happens in Mexico affects our economic security. Mexico is our third largest trading partner -- American exports, jobs and investments are greatly impacted by Mexico's economy. The ripple effects of a crisis there can run throughout the region and across the ocean. In our interconnected world, markets closely monitor how we and major international financial actors treat a crisis in an emerging market. We have an interest, represented by Americans whose jobs and savings are affected by our exports and investments abroad, in minimizing the disruption caused to the international financial system by the financial situation in Mexico. My colleague Under Secretary Summers will address these issues more fully.

Second, what happens in Mexico affects our quality of life, particularly in the southern states. We have almost 100 million Mexican neighbors and a 2,000 mile border. Our common history and this geography present challenges in migration, law enforcement, narcotics interdiction and protection of the environment which we have and will address together. We have a fundamental interest in ensuring Mexico is an able partner and in ameliorating the factors which aggravate these problems.

Third, we have a national interest in promoting regional progress in opening markets and political systems, as the consensus of the Summit of the Americas so powerfully demonstrates. Over the last decade, Mexico has made extraordinary progress in this regard. The elections last August were the most transparent in Mexican history. President Zedillo has pledged to continue the reform process and has already taken several significant steps to do so. It is in our interest to see Mexico succeed. Finally, we have an interest

in maintaining America's leadership in the region.

These national interests compelled the United States to lead the effort to respond to the financial crisis in Mexico. The support package was an international effort: The IMF has committed $17.8 billion, by far its largest package ever. Other nations' central banks, through the Bank of International Settlements, are offering $10 billion. As you know, two weeks ago today, Treasury Secretary Rubin and Mexican Finance Secretary Ortiz signed four agreements providing the framework and setting forth the legal arrangements for the American financial support package. Under the terms of these agreements, the United States will make available up to $20 billion from the U.S. Government's Exchange Stabilization Fund.

The ultimate success of this program, of course, depends on Mexico. The Mexican leadership has made clear that it is prepared to take the stringent economic measures needed to overcome the crisis. The disbursement of American funds will follow our determination that Mexico has indeed pursued sound policies. Repayment is backed, in a binding agreement, by proceeds from the exports of crude oil and petroleum products.

Mr. Chairman, we have acted to protect America's interests and have done so in a way which minimizes our risk. With the stakes as high as they were, the United States could not have failed to exercise leadership. History would have judged us harshly had we stood idly by and allowed Mexico to drift into chaos and the economies of other friends and partners to be disrupted.

Our ties to Mexico involve much more than economic and commercial matters. Millions of people cross our common border legally every year. But the border relationship is complicated. It entails a number of important issues, including the crossing of illegal migrants, the flow of illegal narcotics, other law enforcement concerns and environmental issues, on which we must cooperate. Let me review where we stand on several of these issues.

We have been working with the Zedillo administration on migration, law enforcement and narcotics issues since Attorney General Reno met with Mexican Attorney General Lozano on the margins of President Zedillo's inauguration and agreed to close collaboration on these matters.

Mexican authorities are cooperating with the Immigration and Naturalization Service and taking numerous steps to curb crime and violence along the border and the illegal smuggling of undocumented migrants. The Binational Commission Working Group on Migration and Consular Affairs had a productive meeting on February 13-14, in Zacatecas, Mexico at which the Mexican Government proposed a series of actions for intensified cooperation. For example, the Mexicans agreed to expand the elite Grupo Beta police force to two additional border cities in 1995. Already deployed in Nogales and Tijuana, the Grupo

Beta has proven to be effective in detecting and deterring crimes against migrants, including alien smuggling. They also promised increased measures to address the serious problem of lane and port runners at border bridges and ports of entry, to close access to the infamous Nogales tunnels, to work with us on orderly repatriation procedures, and to implement local development programs to encourage workers to remain in Mexico.

I am pleased to tell you that the Mexican Government has taken concrete steps to implement commitments it made at the Zacatecas meeting. Already additional police officers have been sent to Tijuana to raise port security and stop migrants from running the port. INS has been allowed to share control over border gates to help ensure they stay locked when not in use. The notorious Nogales tunnels, through which migrants and intending criminals have entered into the United States illegally, are now subject to stricter security measures. On Mexico's southern border tighter controls are in place to deter third country nationals who seek to transit Mexico illegally en route to the United States.

Our two governments are firmly committed to fighting the scourge of drug trafficking and production of illicit narcotics, which are, in the words of President Zedillo, Mexico's most serious national security problem. President Zedillo has launched a broad-reaching judicial reform and anti-corruption effort in part to strengthen his government's ability to oppose narcotraffickers. While there is certainly room for improved cooperation, particularly in the interdiction of cargo jets, we believe the Government of Mexico is serious about combatting drug trafficking. Over the past six years, our cross-border cooperation has led to seizures by the Mexican Government of over 120 metric tons of cocaine, tens of thousands of arrests and the eradication of thousands of hectares of opium poppy and marijuana.

In February, we held two very constructive meetings in Mexico City on narcotics and law enforcement issues. The two sides discussed concrete measures to intensify cooperation in combatting narcotics trafficking and in apprehending and bringing fugitives to justice. We identified specific steps to be taken to improve the bilateral mechanisms for controlling the flow of precursor and essential chemicals, combatting money laundering, and facilitating prisoner transfers, extradition, and domestic prosecution of fugitives in Mexico.

Let me say a few words about the discussions we have had on the transfer of Mexican prisoners from U.S. jails to serve their sentences in Mexican prisons. In 1978 the US and Mexico signed a treaty that permits prisoners to be transferred to their country of nationality to serve criminal sentences imposed in the other country. All but 12 of our states have made the decision to use this treaty, others have restrictions that severely limit their ability to participate. Until now, lack of prison capacity in Mexico has limited the number of

prisoners Mexico has been willing to receive. It has also affected the willingness of some US jurisdictions to authorize transfer because of concerns the transferees would be released early to alleviate overcrowding. This year Mexico has committed to accepting up to 400 prisoners and to exploring ways to expand its prison space so that more prisoners can be returned in the future. Its current plans call for expanding prison capacity by approximately 16,000 spaces.

Joint undertakings to protect our shared environment date back to the establishment in 1889 of what is today the International Boundary and Water Commission. In addition, the Mexican Government is working with the EPA and other U.S. Government agencies to develop a new and comprehensive action plan to address border environment issues under the La Paz Agreements.

As a result of NAFTA, however, we have two additional and unique bilateral institutions -- the Border Environment Cooperation Commission, known as the BECC, and the North American Development Bank, or NADBank. Together, these two institutions will help develop and finance badly-needed environmental infrastructure along the border. The BECC and the NADBank are preparing to open their doors for business. The top management of each institution is in place and actively consulting with environmental and financial bodies, state and local governments and the public on both sides of the border. The binational Boards of Directors have met both separately and together. The BECC will be calling soon for project ideas and we expect a great deal of interest on the part of border communities and other interested parties.

These issues -- immigration, law enforcement, counternarcotics, environmental safety -- are important to all of us. We are greatly encouraged by the level of cooperation we enjoy with Mexico, but will continue to press for even greater success. Fundamental to continued progress on these and other issues is the basic stability of Mexico -- both politically and economically. President Zedillo has committed to political reform to complete Mexico's transition to full democracy, and the headlines bear out the bold steps he is taking. The process of return to economic stability has been launched, thanks to US support and leadership.

Another major area of our relationship with Mexico is foreign policy. Now more than ever, Mexico is a major player in the international arena. Within the past 18 months, Mexico not only joined NAFTA, but also became a member of APEC and the OECD. We consult with the Mexican government frequently about matters related to these organizations and to the U.N. and the OAS.

We are in close agreement and cooperate extensively on many issues. However, on Cuba, while we share with Mexico a determination to help bring about a peaceful transition to a democratic government there, we differ with Mexico on how to

achieve this goal. Mexico prefers a strategy of engagement to bring this about. We believe in isolating the Cuban regime.

In the last several years, Mexico has sought closer economic cooperation with Cuba, both to settle Cuba's outstanding debts to Mexico and to position Mexican firms for the expected post-transition boom. As part of this effort, Mexico has promoted a number of debt for equity agreements leading to the acquisition of shares in Cuban entities by Mexican firms.

We have repeatedly expressed our concerns, but Mexico, like Spain, Canada and other U.S. allies, pursues other means to promote reform in Cuba. In our ongoing dialogue on this issue, the Government of Mexico has informed us that it will not settle Mexican debt claims against other governments, such as Cuba, through mechanisms involving the transfer by such government of expropriated properties for which a United States national has an unresolved claim for compensation or ownership. Further, the Government of Mexico's policy is not to provide assistance to the Government of Cuba, and to deal with Cuba only on a commercial basis on market terms. The Government of Mexico has indicated that it does not offer subsidies or concessionary prices to Cuba. The U.S. has no evidence that this is not the case.

Mr. Chairman, let me address a set of issues that has come into sharper view in recent months -- the status of Mexico's political reform efforts during a turbulent past year.

Mexico is continuing its profound political and economic transformation. President Zedillo has been adamant about the need to do more to make Mexico a full democracy. He has pledged additional electoral reform, in particular on campaign and party financing, media access and greater autonomy of electoral institutions. He pledged to separate his administration from the PRI and himself from internal PRI decision making. So far, after only three months in office, he is fulfilling his commitments.

He has recognized the urgent need to reform the Mexican judicial system. In December, he introduced constitutional amendments to improve the accountability of the Supreme Court and the Attorney General's office. He instructed the Attorney General, the first opposition party Cabinet member since the PRI took power in Mexico, to oversee a transformation of the entire system of justice and law enforcement.

President Zedillo has taken bold steps to build a political consensus, consulting with the leadership of all major parties. The dynamic Attorney General is a member of the PAN party, and the first opposition party member to ever hold a cabinet position. Zedillo invited the leader of the opposition PRD party to meet with him, and subsequently met with all the opposition parties in a January 17 session which resulted in a

general agreement on further political reforms.

He has attempted to boost Congress' role in governing -- for example, by inviting the participation of a Congressional commission in the Chiapas peace process.

On February 12, we witnessed a major step forward in Mexico's democratic reform process. Elections in Jalisco, in which the PAN won a resounding victory, were conducted without incident and the results were accepted by all parties. The Jalisco vote was a clear sign that Mexico is evolving into a genuinely competitive, multi-party democracy.

We welcome President Zedillo's political reform efforts and support his plans to bring about in Mexico a fuller expression of participatory democracy.

As Mexico has implemented reform, it has grappled with political turmoil over the past year. As we have witnessed in the past two weeks, Mexican authorities are aggressively pursuing investigations into high-level assassinations. President Zedillo pledged to the Mexican people that his administration would reinvigorate the judicial probes of the murders of PRI candidate Colosio, party leader Ruiz Masseiu, and Catholic Cardinal Posadas. The arrest of Raul Salinas in the Ruiz Masseiu investigation validates Zedillo's promise to pursue justice no matter where it leads. The Government of Mexico's efforts to ensure former Deputy Attorney General Ruiz Masseiu return to Mexico to further illuminate possible efforts to block the investigation of his brother's murder further underline the commitment to full investigation in these cases. His commitment to pursue these investigations, regardless of where they lead, is a bold step forward in ensuring that no one is above the law. It has won praise from a broad cross section of Mexican society.

In Chiapas, President Zedillo sought to reopen avenues of dialogue with the rebels, but rebel intransigence and their attempts to expand the conflict to areas outside Chiapas led him to order the military to regain authority over territory in Chiapas. Zedillo reiterated his commitment to peaceful resolution by halting the military offensive after legal order had been re-established. He has called for a special session of the Congress -- convening this week -- to approve legislation addressing the underlying causes of the problems in Chiapas and providing the guidelines for an amnesty. He accepted the resignation of the Governor of Chiapas -- long a rebel demand. In these efforts, Zedillo has the support of the multi-party congressional peace commission which is playing a key role in the peace process.

Our position has been very clear regarding Chiapas: Governments have the right and responsibility to protect their citizens against violence, but they must, at the same time, respect fundamental human rights.

We continue to urge restraint, respect for human rights and full compliance with the legal process. The United States believes that, as President Zedillo said: "a solution to this conflict should come through full respect for the law, through political channels and through conciliation."

Mr. Chairman, we have faith that Mexico is on the path to financial recovery, to a more secure expression and implementation of democratic ideals and to economic well-being for its people. The path is not an easy one and will require severe sacrifices on the part of the Mexican people. President Zedillo is determined to succeed. President Clinton and this administration is determined to assist Mexico because we are neighbors and friends and because it is in our nation's overriding security and economic interests to do so.

Let me close by highlighting for you once again the signficance of the President's decision to authorize the Stabilization Fund for Mexico. In so doing, he not only led the international effort to resolve a potentially dangerous liquidity crisis in a key trading partner and neighbor, he demonstrated that the United States is prepared to play its unique leadership role in a region emerging into democracy and economic liberalization. He signalled that the United States would play its part, ensuring that the mutual cooperation and support pledged at last year's Summit of the Americas would be an enduring relationship. The institutionalization of democracy and economic liberalization throughout the region ensures our domestic tranquility here at home. Thank you.

Oral Testimony by
Lawrence Summers
Under Secretary of the Treasury
for International Affairs
before the House Committee on International Relations
March 7, 1995

Introduction

Mr. Chairman and Members of the Committee, I appreciate the opportunity to appear before you today to discuss the U.S. response to Mexico's financial difficulties.

On January 31 President Clinton, with strong bi-partisan support from congressional leadership, announced his decision to offer a $20 billion support package to Mexico. The congressional leadership stated jointly with the President that day that immediate action was needed "to protect American jobs, prevent an increased flow of illegal immigrants across our borders, ensure stability in this hemisphere, and encourage reform in emerging markets around the world."

In my written statement to the Committee I have reviewed many of the events leading

up to the President's decision, as well as the details of the financial agreements signed by Secretary Rubin on February 21 implementing the program. In my oral testimony this morning I would like to address four of the more frequently asked questions regarding Mexico's financial situation, and the U.S. support effort.

Safeguarding U.S. Interests

One concern often raised is the extent to which the United States is assuming financial risks by offering support. I want to emphasize that every conceivable precaution has been taken to minimize risks.

Mexico's return to economic stability depends on Mexico's pursuing the right economic policies. That is why U.S. support is contingent on Mexico's commitment to following rigorous monetary, fiscal, and structural policy conditions. These include obligations to pursue negative real money growth, and a budget surplus of 0.5% of GDP, which Mexico agreed upon when it accepted IMF support in January.

U.S. assistance will not serve its purpose if Mexico misuses our support. That is why Mexico's use of our support is governed by a financial plan, with which the United States concurs.

The United States will disburse support to Mexico in stages, following disclosure by

Mexico of how it plans to use any new disbursement. The United States may reject a disbursement if Mexico's planned use of the funds received is inappropriate. Accelerated repayment clauses further protect the United States if Mexico fails to meet key terms of our support.

Provision of U.S. support has been made contingent on Mexico's living up to important transparency and financial reporting requirements. Mexico will make available a broad new array of publications offering timely and accurate information on Bank of Mexico and other government agency operations. New public disclosures will include monthly data on government securities and banking operations, Bank of Mexico quarterly reporting following IMF methodology, and a host of data on monetary aggregates, fiscal revenues and expenditures, public sector borrowing operations, development bank operations, and trade and balance of payment statistics. In short, United States officials will have all the economic and financial information needed to determine how the Mexican economy is performing, and whether Mexico is living up to its commitments.

Let me also emphasize that Mexico is not receiving cheap support. The United States will charge Mexico interest rates for any swaps, and fees for any securities guaranteed, that are higher than necessary to cover the risks the United States will bear. These premiums will begin at 2 1/4% above Treasury bill rates. They will rise the more support is disbursed, to 3 3/4%. That will encourage Mexico to turn to regular private market sources for capital as quickly as possible, rather than relying on us for finance.

All of these provisions minimize the risk faced by the United States. However, in the unlikely event that Mexico cannot meet any obligations under these accords, they are backed by Mexican proceeds from oil and oil products exports, through a new oil mechanism that improves on mechanisms which have been used to back previous Mexican obligations to the United States. Under the new mechanism, Mexico's customers have been given irrevocable instructions to make payments directly to a United States bank, from which proceeds will flow to the New York Federal Reserve Bank. There they can be used to repay the United States if Mexico does not meet its obligations to us.

In the final analysis, the United States is not an ordinary creditor for Mexico. Evidence of Mexican repayment is solid. The United States has provided dollars to Mexico through short-term arrangements five times since 1982, and in 1982 provided Mexico with support through a medium-term, one-year swap arrangement. Mexico fully repaid its obligations under all of these facilities when due for repayment. We are confident that given Mexico's record of repayment to the United States, we will continue to be repaid.

Presidential Authority

A second question that has arisen is whether the President acted within his authority in deciding to use the resources of the Exchange Stabilization Fund (ESF). The bi-partisan congressional leadership, the Department of the Treasury's General Counsel in an opinion

dated February 21, and the Department of Justice have all investigated this issue exhaustively, and their answer is unambiguous. The President and the Secretary of the Treasury have clear legal authority under the ESF statute to provide Mexico with assistance in the present manner, to maintain orderly exchange rates and a stable system of exchange rates. The bi-partisan leadership acknowledged that authority in their joint statement with the President of January 31, declaring that "the President has full authority to provide this assistance."

I want to emphasize that the Administration intends to keep Congress fully informed of the progress we are making in implementing our support package. Secretary Rubin has written to the bi-partisan leadership assuring them that, in addition to the Department of the Treasury's regular classified monthly reports to the Banking Committees on ESF operations, "we intend to prepare on a regular basis a much broader report to provide Congress with a detailed picture of developments in Mexico and compliance with our agreed economic terms and conditions."

Let me note once again that the Mexicans have themselves undertaken commitments to provide a broad new array of financial and economic data. This too will serve to keep Congress fully informed.

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U.S. Support and Mexico's Economic Program

A third important question involving Mexico's financial difficulties is how the U.S. and international support package will work to restore Mexico's economic health.

Two points should be emphasized. First, Mexico's economy is fundamentally sound. As with a bank which suddenly suffers a loss of confidence and experiences a bank run, Mexico's chief problem is one of liquidity, which our support package will address. Second, Mexico has committed itself to pursuing economic policies necessary to reassert underlying economic strength.

Mexico has accomplished a remarkable transformation over the past 6-7 years. Nearly 1,000 state industries have been sold off. Tariffs have been slashed way back, to zero on more than 1/2 of U.S. exports to Mexico. Barriers to investment have been removed. Total public debt as a percentage of GDP has fallen from 75% in 1986 to 45% in 1994, less than the OECD average. The government has slashed spending, moving from a budget deficit that stood at 13% of GDP in 1987 to a budget that has essentially been balanced for three years. Mexico's underlying potential is now solid.

The problems lie in the short-term. Mexico faces a liquidity crisis brought on by macroeconomic policy errors committed last year. A sharp fall in investor confidence has made it impossible for Mexico to refinance short-term debt falling due, as it could under

normal market conditions.

The U.S. and international support package will alleviate that problem by providing Mexico with funds necessary for Mexico to redeem short-term obligations, shifting its debt portfolio to longer-term, less volatile forms of finance. Mexico will gain breathing room until its economic policies restore investor confidence and stability.

The international support package put in place has already helped to reduce the stock of short-term dollar indexed securities from roughly $30 billion outstanding at the beginning of the year, to about $18 billion currently. By year-end 1995, Mexico's financial plan projects that only $5 billion of these securities will remain outstanding.

Ending Mexico's short-term liquidity crisis is one key to success. The other is Mexico's implementation of sound economic policies that will correct the macroeconomic policy errors made last year.

Our support package is based on Mexico's commitment to pursuing the rigorous monetary, fiscal, and structural policies to which it agreed in accepting IMF support in January. Mexico has also committed itself to additional policies in the Economic Policy Memorandum which underlies our support. As the Memorandum declares, a chief goal will be to "stabilize the currency (and) strengthen the peso..."

Mexico's commitments will provide the foundation to help Mexico meet that goal. Mexico will pursue negative real money growth, as well as substantially positive real interest rates. These will help bolster the currency. The government budget will move to a surplus of 0.5% of GDP. Privatization will be accelerated, with electricity, transportation and other government-owned facilities sold off, and the financial sector further opened to foreign investors.

These reforms should give the Mexican economy the capacity to grow once the necessary policy adjustment measures are put in place. But patience will be required. Markets remain nervous. Mexico will go through a period of economic slowdown, before the fundamental health of the Mexican economy reasserts itself.

Lessons from Mexico's Experience

Finally, many have asked what lessons should be drawn from the Mexico experience.

First, we've learned that certain old truths about unsustainable economic policies have become even more true in the age of rapidly-moving money. For all the benefits they bring, international capital markets also require greater policy discipline. As Chairman Greenspan has explained in testimony before the House, the combination of policies pursued by the Mexican government was not sustainable, and ultimately reached a limit at which point the exchange rate was devalued.

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As last year unfolded, Mexico continued to experience political and economic shocks. The sustainability of its macroeconomic policy fell increasingly into doubt. While, based on Mexico's past track record, many commentators and analysts predicted an imminent resumption of capital inflows, U.S. officials became increasingly concerned. Treasury and Federal Reserve officials at a range of levels warned their Mexican counterparts that Mexican policy could well prove unsustainable. Unfortunately, the Mexicans ignored those warnings. Rather, they held fast to the view that the country's loss of reserves did not call for policy adjustments, and would ease once political shocks ended. The Bank of Mexico continued to sterilize its outflow of foreign currency, buying government debt with pesos, and pumping up the money supply. When political shocks continued and policy adjustments were not made, the rate of reserve decumulation became so rapid that in the end Mexico had no alternative but to devalue.

Unfortunately, as the Mexican authorities have since acknowledged, the devaluation, while inevitable at the time it took place, was poorly handled. In conjunction with a number of political shocks that followed, it diminished confidence so sharply that by January the possibility of default, which had seemed unthinkable only a month earlier, became a real possibility.

A second lesson we've learned from Mexico's difficulties is how important it is for developing nations to forge ahead with structural adjustments, in order to attract long-term investment. Mexico has come very far. But continued privatization and institutional reform

will be needed. That will ensure that capital continues to find Mexico an attractive site for investment and growth, making Mexico less vulnerable to a reversal in short-term capital flows.

Finally, Mexico's experience reminds us that the time has come for a review of the international economic and financial architecture. We must think more profoundly about the kind of institutional mechanisms we can forge to deal with problems of this kind in the future, and much more importantly, to prevent problems of this kind from arising in the future. President Clinton and the G-7 leaders launched such a review at their Summit last year, and we will present ideas for further discussion at the upcoming Halifax Summit.

Conclusion

Allow me to conclude by emphasizing that the Administration has not acted as it has to protect Mexican interests -- as close an ally and partner as Mexico is. Rather, President Clinton acted to protect U.S. interest -- the jobs, exports, immigration concerns and security issues that would have been threatened by a Mexican collapse. Mexico's financial instability highlights as markedly as any recent event both all the benefits, as well as all the new challenges we face in an increasingly interconnected financial world. The proper response to those challenges is to continue to assert United States leadership. We must continue to play our role, embracing the future, rather than retreating behind the walls of the past. Thank you.

DEPARTMENT OF THE TREASURY
WASHINGTON

GENERAL COUNSEL

The Honorable Robert E. Rubin
Secretary of the Treasury
Washington, D.C. 20220

Re: Authority of the Secretary of the Treasury with Respect to Use of the Exchange Stabilization Fund for the Mexico Support Package

Dear Mr. Secretary:

As you requested, following is the opinion discussing your authority with respect to use of the Exchange Stabilization Fund for the Mexico Support Package.

I. The Proposed Program

On January 31, 1995, the President and Congressional leadership issued a joint statement in which they recognized that "unique and emergency circumstances" existed in the Mexican financial crisis. Acting in response to that crisis, and with the approval of the Congressional leadership, the President has proposed that the United States use the Exchange Stabilization Fund (hereinafter "ESF" or "the Fund") to provide a program of conditional financial assistance to Mexico. Under the program, up to $20 billion from the ESF would be used to support short-term swaps,[1] medium-term swaps having maturities of up to five years, and securities guarantees having maturities of up to ten years. The purpose of the swaps and guarantees is to assist Mexico in stabilizing its exchange and financial markets by providing resources to be used in such manner as to facilitate the redemption, financing or restructuring of Mexico's short-term debt obligations. This action is intended to help resolve Mexico's liquidity problems and to help stabilize the foreign exchange market.

To assure repayment of the swaps and guarantees in the unlikely event that Mexico fails to make timely payments on amounts due, the United States will require Mexico to establish a payments facility whereby the proceeds of Mexican oil exports will be made available to a Mexican Government account at the Federal Reserve Bank of New York, which would then use the

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[1] These include short-term swaps to be provided by the Federal Reserve Bank of New York, acting at the direction of the Federal Open Market Committee, for which the Treasury Department will provide backing.

proceeds to set off obligations owed to the United States. In addition, as added protection in the unlikely event of a default, the United States is requiring Mexico to maintain the value of the pesos it deposits with the United States for the medium-term swaps. Therefore, should the rate of exchange of the peso against the U.S. dollar drop during the time the United States holds pesos, Mexico would be required to provide the United States with enough additional pesos to reflect the rate of exchange prevailing at the conclusion of the swap.

In developing the proposed support program for Mexico, the United States has been working in concert with the International Monetary Fund (IMF). The IMF Board has approved up to $10 billion in additional assistance on top of its already unprecedented level of support, bringing the total IMF commitment up to $17.8 billion. In addition, the IMF is serving as a catalyst for support from other possible lenders.

II. The Exchange Stabilization Fund

a. Purpose

The ESF was established pursuant to section 10 of the Gold Reserve Act of 1934. As amended,[2] that legislation authorizes the Secretary of the Treasury, with the approval of the President, to deal in gold, foreign exchange, and other instruments of credit and securities "consistent with the obligations of the Government in the International Monetary Fund on orderly exchange arrangements and a stable system of exchange rates[.]" 31 U.S.C. 5302(b). In addition, the statute provides that "a loan or credit to a foreign entity or government of a foreign country may be made for more than six months in a twelve month period only if the President gives Congress a written statement that unique or emergency circumstances require the loan or credit be for more than six months." Id.

One of the main impetuses for the establishment of the Fund in 1934 was the concern that comparable funds established by European nations could have a significant impact on exchange markets to the detriment of the dollar. The ESF was established in large part to help the United States counteract those foreign pressures. See H. Rep. No. 292, 73d Cong. 2nd sess., 2 (1934). As originally enacted, section 10 of the Gold Reserve Act authorized the Secretary to take measures "for the purpose of

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[2] This section was codified at 31 U.S.C. 5302 as part of the permanent codification of Title 31 in 1982.

stabilizing the exchange value of the dollar."[3]

Since 1934, however, section 10 has been amended so that its focus has broadened from the stabilization of the dollar to include orderly exchange arrangements and a stable system of exchange rates. In general, this broadening reflects the evolution in the monetary system from 1934 to the present, and in particular the establishment of the international financial institutions in 1945 and the move away from the gold standard and a fixed exchange rate system.

b. History and Background

To enable the Secretary to carry out the provisions of section 10, Congress initially appropriated to the ESF in 1934 $2 billion of the increment resulting from the reduction in the weight of the gold dollar. The ESF was originally established as a two-year fund, subject to renewal by the President for an additional year. The President renewed the fund for an additional year in 1936, and the fund was subsequently renewed for successive two-year periods by Congress from 1937 until 1943.

In 1945, under the Bretton Woods Agreements Act, the ESF became a permanent, although much smaller, fund. That act authorized the Secretary of the Treasury to pay from the Fund $1.8 billion to the International Monetary Fund (IMF) as part of the United States subscription to that institution. The remaining $200 million in the Fund was intended to be "extremely useful in supplementing the work of the International Monetary Fund with respect to those countries that have close economic ties with the United States, and particularly those with which we now have bilateral stabilization agreements." See H. Rep. No. 629, 79th Cong., 2nd Sess. 3 (1945).

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[3] The Senate Banking Committee's report contains the following description of the original objectives of the ESF:

> It is interesting because [the ESF] is the most ingenious instrument ever developed in the monetary systems. It is equally effective in attack and defense. The reason for its establishment in this case is to defend the American dollar and our gold stocks against the invasion of similar funds operated by competitor nations. . . . The [British] equalization fund was so effective in driving up the dollar that we were forced off the gold standard. It is to prevent a repetition of this experience that we create the stabilization fund preparatory to the return to gold redemption.

S. Rep. No. 201, 73d Congress, 2d Sess. 2-3 (1934).

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In 1962, an amendment to the Bretton Woods Agreements Act provided that any currencies or gold purchased by the United States from the IMF may be transferred from the General Fund of the Treasury to the ESF and administered as part of the ESF. Pursuant to the Special Rights Drawing Act of 1968, Special Drawing Rights (SDRs) allocated to the IMF or otherwise acquired by the United States are resources of the ESF.[4] In accordance with the Special Rights Drawing Act, SDRs can be monetized by the Secretary of the Treasury through the issuance of Special Drawing Rights Certificates to the Federal Reserve in an amount not to exceed the dollar value of the ESF's SDR holdings. As of September 30, 1993 (the date of the most recent annual report of the ESF), cumulative allocations to (i.e., liabilities of)[5] the United States totalled SDR 4,900 million (over $6.9 billion), and U.S. holdings (assets) of SDRs totalled SDR 6,488 million (about $9.2 billion).

Reflecting the termination of the fixed exchange rate system and the amendments to the Articles of Agreement to the IMF, section 10(a) of the Gold Reserve Act was amended in 1976 to specify that the ESF is to be utilized as the Secretary "may deem necessary to and consistent with the United States obligations in the International Monetary Fund." Pub. Law 94-564, 90 Stat. 2660, 2661. Section 10(b) was amended one year later to clarify further that those obligations are to maintain orderly exchange arrangements and a stable system of exchange rates, rather than to maintain any particular value of the dollar. Pub. Law 95-147, 91 Stat. 1227, 1229. In introducing the amendatory language, Senator Helms explained that ". . . the amendment would amend the Gold Reserve Act to specify that the purpose of exchange stabilization is not exclusively to "stabilize the exchange value of the dollar." Cong. Rec. S 16919 (Oct. 11, 1977)(emphasis added).

The 1977 amendments also clarified that in the event that

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[4] A Special Drawing Right (SDR) is an official reserve asset and a unit of account composed of a "basket" of the currencies of five IMF members having the largest exports of goods and services. These currencies are the U.S. dollar, Japanese yen, German mark, French franc, and U.K. pound. The valuation rate for SDR holdings and allocations is computed by the IMF based on the exchange rates of these currencies. The SDR holdings and allocations are revalued monthly based on the SDR valuation rate, and a gain or loss on that revaluation is recognized.

[5] These liabilities must be discharged only in the event of liquidation of or U.S. withdrawal from the SDR Department of the IMF or cancellation of SDRs.

the Secretary wishes to offer a loan or credit exceeding six months, he can do so if the President provides a written determination to Congress that unique or emergency circumstances make such a loan or credit necessary for a term greater than six months. The stated purpose of this amendment is to assure that, in general, ESF loans and credits are short-term, are used to counter market disorder, and do not undercut the IMF's role as the principal source of medium-term balance of payments financing. See S. Rep. No. 94-1295, 94th Cong. 2d Sess. 11 (1976). Indeed, in the normal course, measures to combat disorderly foreign exchange conditions can be completed in the short-term. Although the Exchange Stabilization Fund has been used to provide loans to foreign governments many times since its creation in 1934, it has not been used to offer loans or guarantees with maturities in excess of one year.[6]

Until fiscal year 1980, the administrative expenses associated with the international affairs function of the Treasury Department were financed from the resources of the ESF, pursuant to the Gold Act of 1934. In 1978, legislation was enacted providing that the Fund is not available to pay the administrative expenses of the Fund. Since that time, such administrative expenses have been funded by appropriations.

III. The President and the Secretary of the Treasury Have the Authority to Implement the Proposed Program Through the Exchange Stabilization Fund.

a. The Provision of Loans and Credits to Mexico is a Permitted Use of ESF resources.

In the Mexican support package, the ESF will be providing Mexico with three types of financing--short-term swaps, medium-term swaps, and securities guarantees with maturities of five to ten years. In a typical ESF swap transaction, a foreign country borrows U.S. dollars and agrees to repay them on a certain date at a specified rate of interest. In addition, at the time of the borrowing, Treasury takes possession of a corresponding amount of the foreign country's own foreign currency, which Treasury invests in the government securities of that country. Treasury returns the foreign currency to the country once the country has fully repaid the borrowed dollars, with interest at the specified

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[6] The President has invoked the authority under the ESF statute to exceed the usual six-month limit once before. In 1982, at the onset of the debt crisis, President Reagan notified Congress that emergency circumstances required the extension of loans and credits to Mexico for one year. Mexico fully repaid the loan on a timely basis.

rate.

Under the proposed package, the ESF will also agree to satisfy, or be answerable for, payments due holders of Mexican Government securities in the event the Mexican Government fails to make payment to these holders when due, up to an agreed specified amount. These guarantees thus operate like a line of credit, under which a set amount of money is made available to a borrower, to be drawn down if needed.

Although loans and credits are clearly permitted under the ESF, their purpose must be to maintain orderly exchange arrangements and a stable system of exchange rates, and not to serve as foreign aid. Therefore, in all swap transactions, Treasury has taken steps to assure that there is a source of repayment of the ESF.[7] For example, ESF swap agreements have frequently been tied to an IMF stabilization program, with drawings on the ESF "bridged" to drawings on the IMF.

The assured source of payment for the Mexican loans and guarantees will be the proceeds of Mexican oil sales, which will be made available to the United States under the payment facility described earlier. In addition to the oil payments facility, as explained above, the United States is also requiring Mexico to maintain the value of the pesos that it provides under the medium-term swap as a further measure of protection to the United States. The United States will also be charging Mexico interest rates for the medium-term swaps and fees for the securities guarantees that are designed to compensate the ESF for the risk of providing the funds, and to provide an incentive to Mexico to rely on private capital markets for its financing needs.

b. The Mexican Support Package is Consistent with the Obligations of the United States in the International Monetary

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[7] Lack of an assured source of repayment has been the reason underlying prior decisions of the Treasury Department to decline to use the ESF as a source of lending to a foreign country. For example, in considering possible assistance to Poland in 1989, the Treasury Department informed Congress that "it is prepared to consider positively a bridge loan to Poland but could not make a commitment except in conjunction with an agreement between Poland and management of the IMF and identification of assured sources of repayment. In addition to funds available under an IMF program, disbursements from the World Bank could be considered." See United States Economic Programs for Poland and Hungary: Hearings and Markup before the Committee on Foreign Affairs, 101st Cong., 1st Sess. 163 (1989)(emphasis added).

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Fund on Orderly Exchange Arrangements and a Stable System of Exchange Rates.

The Articles of Agreement of the International Monetary Fund (the Articles) is the basic document that creates that institution, specifies its functions, and spells out the major obligations of its members. Article IV of the Articles ("Obligations Regarding Exchange Arrangements") establishes the general principles for members to follow in pursuing monetary policies that affect rates of exchange between the domestic currency and foreign currencies.

As originally drafted in 1945, Article IV established a system of fixed exchange rates. The Fund required each member to state a par value for its currency in terms of gold, or in terms of the U.S. dollar of fixed gold value, and to maintain exchange rates within a narrow band. Largely at the instigation of the United States, Article IV was amended in 1978, to remove this obligation.[8] Under the present Article IV, members are given the freedom to choose whatever exchange arrangements they prefer so long as they are consistent with the basic guidelines set out in Article IV, section 1. The IMF oversees the exchange arrangements of its members through a monitoring process referred to in section 3 of Article IV as "surveillance."

Article IV provides that the basic obligation of the members with respect to exchange arrangements is "to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates." In connection with this obligation, each member in particular commits under Article IV to seek, inter alia, "to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions." This is consistent with the language that was adopted in the 1977 amendment of section 10 of the Gold Reserve Act, which replaced the long-standing reference to maintaining

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[8] The House Banking Committee noted in 1976 that it strongly supported this change as well. In its report accompanying amendments of the Bretton Woods Agreements Act, it stated: "This abandonment of fixed, in favor of floating, exchange rates reflects a general recognition that, at least under present economic conditions, attempts to maintain fixed exchange rates are futile and counterproductive. A major objective of the United States in negotiating international monetary reform was the amendment of Article IV to permit greater flexibility of exchange rates. . . This Committee has long supported this objective, and welcomes the success of the administration in negotiating a new Article IV embodying this principle." H. Rep. No. 94-1284, 94th Cong., 2d Sess. 4 (1976).

the value of the dollar. That amendment clarified that the purpose of the Fund was to deal in gold, foreign exchange, and other instruments of credit consistent with the obligations of the United States in the IMF "regarding orderly arrangements and a stable system of exchange rates." Pub. L. 95-147, sec.4.

The Mexico support package is clearly consistent with these purposes. The current Mexican financial crisis is a liquidity crisis that has had a significant destabilizing effect on the exchange rate of the peso, with consequences for the overall exchange rate system. See generally Press Conference of Michel Camdessus, Managing Director, IMF (Feb. 2, 1995)(hereinafter Camdessus Press Conference). The spill-over effects of inaction in response to the peso crisis would be significant for other emerging market economies, particularly those in Latin America, as well as for the United States.[9] As IMF Managing Director Camdessus stated in his explanation of the IMF's current role in assisting Mexico, "as the central institution of international monetary cooperation, [the IMF] had the responsibility not only to provide financial support for Mexico's program and thereby to give confidence to Mexico, but also to respond to the systemic implications of the Mexican crisis and to give confidence to the international financial system." Id. (Emphasis added.) (See also remarks of Chairman Greenspan and Under Secretary of State Tarnoff before the House Banking Committee, Feb. 9, 1995.) Similarly, even if the ESF remained limited to its original relatively narrow purpose of maintaining the value of the dollar, the Mexico support program would be consistent with that purpose.[10]

c. The President has broad discretion to make medium-term loans and credits available under the ESF for the purposes of section 10.

(i) Congress has not limited the discretion of the President and, acting with the President's approval, the Secretary of

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[9] See "Worries About U.S. Aid Package and Defaults in Mexico Depress Prices in Emerging Markets," Wall Street Journal, Feb. 17, 1995.

[10] If recent foreign exchange market activity is any indication, the ability of the peso crisis to have a negative impact on the exchange rate of the U.S. dollar may already be in evidence. See "D-Mark rises as Mexican Financial Crisis Hits Dollar," Financial Times, Feb. 17, 1995 at 1; "Dollar Falls on Fears in Peso Crisis: U.S. Financial Toll Seen if Bailout Fails," New York Times, February 17, 1995; "Dollar Plunges Against Mark and Yen; Mexico, Rush to German Currency Cited," Wall Street Journal, Friday, Feb. 17, 1995.

the Treasury to use the ESF.

Since its inception, the ESF has been operated at the complete discretion of the Secretary of the Treasury, acting with the approval of the President. During the House debates on the 1934 legislation, Congressman Dies, a member of the Coins, Weights and Measures Committee, led off the discussion by explaining in detail the objectives of the proposed legislation. Concerning the operations of the ESF, he described the operation of the British exchange equalization fund, which, he maintained, had already greatly increased the Bank of England's gold and foreign exchange reserves. He noted that the British fund

> began to operate at once with the greatest secrecy. Its operations are under the law of England veiled in secrecy, and there is no way of ascertaining its activities except by appraising the results . . . It is imperative that we resist the operations of the [British] equalization fund. The only feasible method by which this can be accomplished is to establish a similar fund, and to clothe the Secretary of the Treasury and the President with equal powers and resources. . . . [T]he Parliament decided that the success of the [British] fund would be destroyed if its operations were not veiled in the greatest secrecy. For the same reason Congress will have to impose confidence in the honesty and integrity of the Secretary of the Treasury and the President.

78 Cong. Rec. 966 (January 20, 1934).

Since 1934, Congress has held a number of hearings concerning the ESF, and considered various proposals to limit the President's or the Secretary of the Treasury's authority with regard to the Fund. For example, in 1934, there were a number of proposals to vest control of the ESF in a five-member board, similar to the British Fund, which was under the control of three individuals. See H. Rep. 292, 73d Cong., 2nd Sess., Part 2 (1934). These proposals were defeated in recognition of the importance of giving the Secretary of the Treasury the utmost discretion and confidentiality possible.

In more recent times, questions have been raised about the breadth of the Secretary of the Treasury's discretion with regard to the Fund. On at least two occasions, the House Banking Committee has held hearings to examine the role of the ESF and, in particular, the authority of the Secretary of the Treasury. See, e.g., Exchange Stabilization Fund and Argentina: Hearings Before the Subcommittee on International Trade, Investment and Monetary Policy of the Committee on Banking, Finance and Urban Affairs, House of Representatives, 98th Cong., 2d Sess. (May 1 and 15, 1984); and Review of Treasury Department's Conduct of

International Financial Policy: Hearing Before the Committee on Banking and Finance and Urban Affairs, House of Representatives, 101st Cong., 2d Sess. (August 14, 1990). These hearings did not result in any changes being made to the Secretary of the Treasury's authority with regard to the ESF.[11] The Secretary's decisions with respect to the manner in which fund resources are to be deployed remain final and unreviewable by any other "officer or employee of the Government." 31 U.S.C. 5302(a)(2).

Given the purpose of the ESF as a means of maintaining order in exchange markets and its genesis as a tool for counteracting similar funds held by other countries, it is entirely reasonable that Congress has vested complete discretion in the Secretary of the Treasury and the President for the operation of the Fund. As the chief financial policy official of the U.S. Government, the Secretary of the Treasury is uniquely situated in the Government to make the complex judgments necessary to determine the need for intervention in currency markets at any particular time. Moreover, as the official primarily responsible for the conduct of the foreign affairs of the United States, the President has the expertise and perspective to determine whether particular circumstances are unique or sufficiently serious to warrant longer-term efforts at stabilization.[12]

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[11] There have also been several occasions where Congress has examined the ESF and decided against making any major changes to the basic operation of the Fund. In 1939, when Congress enacted a requirement that the Secretary of the Treasury provide an annual audit of the Fund to Congress, the Senate Committee Report stated that "secrecy as to the day-to-day operations of the fund is necessary to its success. That the Congress may be informed as to its operations, however, the bill provided that a report of the annual audit of the fund be submitted to Congress as well as to the President." H. Rpt. No. 406, 76th Cong., 1st Sess. (1939) at 1. In 1976, the Congress considered and rejected a proposal to put the ESF into the budget. See Exchange Stabilization Fund: Hearing before the Task Force on Tax Expenditures and Off-Budget Agencies of the House Budget Committee, 94th Cong., 2d Sess., (Feb. 18, 1976). The Congress has also rejected a proposal to require a GAO audit of the Fund. Although two years later the administrative expenses of the Fund were put into the budget, the Fund itself continues to be outside the budget and is not audited by the GAO. See Pub. Law 95-612.

[12] The latitude afforded the President in this context is similar to the discretion he has been granted under another statute that deals with unusually serious situations, the International Emergency Economic Powers Act. Even in that context, where the range of possible Presidential action is

(ii) Congress has not imposed any term limits on loans or credits made under the ESF.

Similarly, Congress has not placed any term limits on loans or credits made under the ESF. Under the 1977 amendment to the statute, the Secretary may provide loans or credits in excess of six months if the President provides Congress with a written statement that unique or emergency circumstances require such longer-term measures. Thus, Congress has not limited the President's ability to take action, but has asked only that the President recognize that extraordinary measures be reserved for extraordinary situations. As Representative Hamilton observed at a 1989 House hearing on possible U.S. financial assistance to Poland and Hungary, the President and the Secretary of the Treasury plainly have the legal authority to use the ESF for longer-term assistance in certain circumstances. See United States Economic Programs for Poland and Hungary: Hearings and Markup before the Committee on Foreign Affairs, 101st Cong., 2nd Sess. 168 (1989). Ultimately, the Treasury Department determined that the particular circumstances at hand in the case of Poland did not warrant use of the ESF. See id. at 175.

The extension of loans and credits to Mexico under the proposed support program is consistent with what Congress intended when it amended the ESF provision in 1977 to require Presidential notification in the event that longer-term loans or credits were deemed necessary. Although Congress has expressed a preference that the ESF be used primarily for shorter-term lending, it has acknowledged that longer-term efforts are sometimes necessary. The Senate Banking Committee explained that it

> recognizes that there may be circumstances where longer-term ESF credits may be necessary, and the amendment provides for that possibility. But the Committee intends, and the amendment expressly provides, that such longer-term financing be provided only when there are unique and exigent circumstances. As indicated by Treasury, these would include natural disasters, trade embargoes, unforeseen economic developments abroad, political assassinations, or other catastrophic events.

S. Rep. No. 94-1295, 94th Cong., 2nd Sess. 11 (1976) (quoting letter from Under Secretary of the Treasury for Monetary Affairs Edwin H. Yeo to Adlai E. Stevenson, Sept. 1, 1976)(emphasis added). Given both the current financial crisis in Mexico and

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broader than under the ESF, Congress has not limited the President's ability to invoke the authority of the statute when he determines that it is necessary to do so.

the political difficulties that country has faced in the past few months, the criteria for longer term actions suggested by the Treasury Department in 1976 and implicitly adopted by the Senate Banking Committee are easily satisfied in this case.

The flexibility to retain a longer-term option for the purpose of addressing serious exchange market disruptions is critical. The ESF plays an important complementary role to the Federal Reserve Board, which also has the authority to intervene in foreign exchange markets in the interest of maintaining their stability. However, the Federal Reserve Board is more limited than the ESF in the types of transactions it can undertake. In the context of 1976 hearings concerning a proposal to change the budget treatment of the ESF, former Board Chairman Paul Volker explained the differences between the Board's and the ESF's powers in this area to Representative Sam Gibbons, Chairman of the Task Force on Tax Expenditures and Off-Budget Agencies, Committee on the Budget:

> . . . Federal Reserve operations are more limited than the potential operations of the ESF. The ESF, although its resources are much smaller, can respond in a greater variety of ways to contingencies not envisaged in guidelines for Federal Reserve operations. The ESF can, for instance, engage in transactions with countries that may not be included in the System's overall swap network. Since ESF financing can more easily be arranged on an ad hoc basis instead of as part of an overall network of credits, as is the case for the Federal Reserve, the ESF can respond more flexibly to unusual or special circumstances, attaching such conditions and specifications to those financing as may be appropriate to each operation. The ESF has also been assigned a number of significant functions with respect to SDRs. <u>It can undertake operations to deal with unusual market situations which might entail a longer-term exposure than is appropriate for the System under the swap arrangements.</u> And, it can potentially supplement the amount of financing that is available to any country under System swap arrangements.

<u>Exchange Stabilization Fund:</u> Hearing before the Task Force on Tax Expenditures and Off-Budget Agencies of the Committee on the Budget, House of Representatives, 94th Congress, 2d Sess. 81 (1976)(emphasis added).

In its Report accompanying the 1976 bill, the Senate Banking Committee expressed concern that, given its size, the ESF could be used as a potential source of bilateral assistance for foreign

exchange purposes outside the IMF.[13] The Committee went on to explain that

> to the extent that such assistance permits a country to avoid necessary changes to its economic policies, it undermines the IMF's goal of inducing necessary adjustments in policy to promote orderly economic growth and stability. In order to insure that ESF operations are not inconsistent with the goals of the IMF, the Committee has adopted an amendment emphasizing the intended short-term nature of ESF lending. The goal is for the United States to place primary reliance on the IMF and to confine foreign exchange lending operations outside the IMF to short-term operations.

S. Rep. No. 94-1295, 94th Cong., 2d Sess. 11 (1976)(emphasis added).

As explained above, the United States is complementing rather than supplanting the IMF in providing loans and credits to Mexico. The IMF plays a catalytic role in helping members finance balance of payments shortfalls, and a safety net role in the event that other sources of assistance are inadequate. The IMF has endorsed the President's Mexico support package. Recognizing the magnitude of the peso problem, and the substantial resources that will be necessary to address it, the IMF is playing a significant role in helping Mexico marshall funds from other sources. See Camdessus Press Conference at 8-9. In response to a question concerning the possibility of future

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[13] In response to a question from the Senate Banking Committee as to why the ESF should not be restricted to short-term lending exclusively, so that it does not compete with the IMF, then-Under Secretary of the Treasury for Monetary Affairs Edwin H. Yeo explained:

> Although the ESF is likely to be used primarily for short-term lending, a statutory requirement that it be used for short-term lending exclusively would not be appropriate and would unnecessarily impair U.S. flexibility, especially in unforeseen circumstances, in implementing our international monetary policy. While operations have on occasion been used to complement IMF lending, no question of "competition" with the IMF would be expected to arise. The ESF--with such limited resources--in fact could not "compete" with the IMF as a major source of balance of payments financing.

See Amendments of the Bretton Woods Agreements Act: Hearing Before the Subcommittee on International Finance of the Committee on Banking, Housing and Urban Affairs, U.S. Senate, 94th Cong., 2d Sess. 158 (1976).

serious currency difficulties in other countries, Mr. Camdessus said:

> It is true that the Mexican case is truly exceptional for the United States of America; the authorities of our host country have put that very clearly. This gives the IMF an added obligation to be ready to step in, at least as convincingly, if not more, in cases where we could not expect the same kind of support from the United States of America. We are working to this effect. As I have already said, we now have the appropriate means for doing that, but we also urgently need to convince our shareholders to equip us better for whatever crisis situation might emerge.

Camdessus Press Conference, Feb. 2, 1995, at 10.

IV. Conclusion

Longer term assistance is clearly required in this instance. The Mexican peso crisis has erupted with such suddenness and in such magnitude as to render the usual short-term approaches inadequate to address the problem. While the problem is caused largely by a tremendous over-hang of short-term debt, longer-term solutions are necessary to take into account Mexico's debt servicing capacity and avoid further pressure on the exchange rate of the peso.

As shown above, the language of the ESF statute clearly permits such assistance. In the more than sixty years of the ESF's existence, Congress has never seen any reason to limit the President's ability to draw on the Fund's resources, provided that he did so in accordance with the basic purposes of section 10 of the Gold Reserve Act, as amended and presently codified in title 31. To the contrary, Congress has considered and rejected various proposals that would have limited the President's or the Secretary of the Treasury's authority to act, or subjected them to greater Congressional oversight. The highly technical and complex area of foreign exchange and exchange market stability blends important considerations of monetary and foreign policy. It is an area that is properly left to the discretion of the President and, acting with the President's approval, the Secretary of the Treasury.

Sincerely,

Edward S. Knight

Edward S. Knight
General Counsel

Question for the Record Submitted to
Under Secretary of State Peter Tarnoff
International Relations Committee
U.S. House of Representatives
March 7, 1995

Question:

1. What is the status of relations between President Zedillo and his predecessor Carlos Salinas? What impact has the feud with Salinas had on Zedillo's ability to govern Mexico? What has been the public reaction to the feud between Zedillo and the former President? Was this weekend's "exoneration" of Carlos Salinas regarding participation in any cover-up in the Colosio assassination politically motivated or based on facts?

Answer:

Former President Salinas departed Mexico on March 10 after conducting a brief public campaign to defend his reputation and some of his actions while in office, including the handling of the economy. Both Zedillo and Salinas have denied reports that Zedillo requested his predecessor's departure from Mexico. Mexican presidents traditionally withdraw from public life after leaving office, so Salinas' statements have been interpreted as a disagreement with President Zedillo. It has not impacted on Zedillo's ability to govern. According to recent opinion polls, the Mexican public blames Salinas for the current economic crisis, Salinas' statements notwithstanding.

President Zedillo is firm in his commitment to pursue the investigations into high level assassinations. His actions have demonstrated his resolve to ensure that no one in Mexico is above the law. Political considerations do not appear to be a factor in these on-going investigations.

Question:

2. Are the recent arrests in the Ruiz Massieu and Colosio assassinations a reaction to pressure on the Zedillo administration from the Mexican military? Was the Mexican military preparing to move against Zedillo if he had not acted on those cases? Does the Mexican military pose a continuing threat to the Zedillo Administration? What contact have U.S. officials had with the Mexican military in recent weeks? What message are we conveying to the Mexican military?

Answer:

In his December 1 inaugural address, President Zedillo said that his administration would reinvigorate the Colosio and Ruiz Massieu investigations because the Mexican people were not satisfied with the results. Zedillo has vigorously pursued the investigations and shown his resolve to ensure that no one is above the law. We are not aware of any pressures from the Mexican military concerning the investigations.

The Mexican military has a long-standing tradition of respect for civilian authority. We discredit recent press reports regarding military coup plotting. The military does not pose a threat to the civilian government; indeed, it consistently carries out presidential orders, most recently in reasserting government authority in the Chiapan highlands.

We maintain regular communications with the Mexican military through our Embassy in Mexico City and with Mexican military attaches assigned to the United States. We do not have a particular message to convey to the military, but instead have shared with all levels of the Mexican government our concerns that operations in Chiapas be carried out with appropriate restraint, respect for human rights and full compliance with the legal process in Mexico.

Question:

3. How severe is the division between reformers and hardliners within the PRI? Is there any possibility that the PRI will formally split? What impact has the arrest of Raul Salinas had on party rank-and-file support for Zedillo? How great do hardline elements of the PRI pose to political stability in Mexico?

Answer:

The PRI remains the only political party in Mexico with a substantial base throughout the country. We do not foresee its demise or a formal split over the issue of reform. However, the party must address a changing political environment in Mexico if it is to retain voter support. Public discontent with the economic crisis could result in protest votes against in the PRI in upcoming state and local elections.

The PRI has maintained its support for President Zedillo and displayed extraordinary party discipline during recent congressional votes on the new austerity measures. That support, which we believe will continue, is important to the success of the economic plan.

President Zedillo's efforts to revitalize the investigations into high level assassinations has met with support throughout Mexico. Public opinion polls showed widespread approval for the arrest of Raul Salinas and other recent actions in connection with these investigations.

Question:

4. How has the economic crisis effected the pace of political reform in Mexico? Has it not accelerated the pace of reform? How would you characterize the January political pact? Why should we take the pact any more seriously than those of the past? What forces are working against further reform? What follow through has there been on changing the Mexican political system since the pact was signed?

Answer:

President Zedillo is adamant about the need to strengthen the political reform process in Mexico. He has pledged additional electoral reform, in particular on campaign and party financing, media access and greater autonomy of electoral institutions. He has also recognized the need for wholesale reform of the Mexican justice system. The economic crisis has propelled President Zedillo and other political leaders to advance further the reform process. There are elements in Mexico which fear a deepening of political reforms, but Zedillo's efforts in this area have the support of the majority of the Mexican people.

Zedillo has taken unprecedented steps to reach out to the opposition parties and to expand the role of the Mexican Congress. His efforts at building a political consensus lead to the January 17 signing of the intra-party pact on further reforms. Unlike previous political pacts, the January 17 agreement was the result of direct consultations between the president and leaders of the major parties. Since the signing of the pact, the Mexican government and the major parties have continued to cooperate in setting an agenda for additional reforms. The successful February 12 elections in Jalisco were a sign that Mexico is evolving towards a fully participatory democracy.

TESTIMONY OF CONGRESSWOMAN MARCY KAPTUR (D-OH)

I wish to thank Chairman Gilman for allowing me to submit my testimony on this Mexican rescue package as presented on February 22, 1995.

I would like to thank the distinguished chairs of the Subcommittee on the Western Hemisphere, Congressman Burton, and the Subcommittee on International Economic Policy and Trade, Congressman Roth, for holding this hearing today on the $47.5 billion bailout of Mexico.

The Administration's use of public money in such a manner, and specifically, the use of the Exchange Stabilization Fund by the U.S. Treasury, is absolutely unprecedented in both magnitude and duration -- and is, in my judgment, illegal. When I questioned Secretary Rubin on February 14, 1995 at the annual Appropriations Committee Budget Overview Hearing, he reluctantly confirmed to me that there is no precedent for the Administration's action. The United States has never extended loans to a foreign country on a medium- or long-term basis on such a huge scale (see attached chart). This unilateral action by the Executive Branch is 20 times as large as any previous use of this Fund and has been structured for different purposes, as I will elaborate.

Moreover, never has it been the will of Congress to provide the Executive Branch with unlimited authority of this sort as a function

of the Exchange Stabilization Fund. As many observers have commented, this situation goes well beyond a short-term liquidity crisis in Mexico or a need to defend the dollar in foreign markets. This is an aggressive foreign aid authorization to Mexico to prop up a failing economy that has its roots in deep-seated political corruption, the lack of a rule of law, and a mismanaged economic program.

I would like to call your attention to some testimony that this very Committee heard on October 10, 1989, which I believe is extremely applicable to what we are discussing today, and excerpts from which I have attached to my own written remarks. The testimony came from officials at the Treasury Department and the State Department who were being questioned by Congressman Gilman in connection with a proposed economic aid package for Poland.

Rep. Gilman: I'd like to ask our distinguished panelists -- there's been a great deal of discussion about the possible utilization of a loan from the Treasury's Exchange Stabilization Fund to help stabilize the zloty as Poland tries to attack its inflationary problem. And I know our good chairman, the gentleman from Indiana, Mr. Hamilton, has raised that issue. Can you tell us, has serious consideration been given to that, and is that possibility presently under review? And does the Treasury Department have the authority to loan to Poland under this program?

Mr. Barreda: Mr. Congressman, the administration has decided to support a Polish fund for stabilization. We think the appropriate way to do that is through an appropriation by Congress. We think the Exchange

Stabilization Fund's purpose and use is quite different. We've used the Fund for intervention exchange markets and for very short-term loans, usually bridged to a guaranteed repayment in a hard currency. The proposal to provide Exchange Stabilization funds to Poland on a longer-term basis is a totally different use of the funds. That is much closer to foreign aid, Mr. Congressman. We think, therefore, it should be appropriated.

* * *

Rep. Hamilton: Now, let me ask some questions about the exchange stabilization fund. I'm not sure that I understood the testimony correctly early on. But . . . you said it was used only for short-term loans. Is that correct?

Mr. Barreda: That's right, sir.

Rep Hamilton: By which you meant what?

Mr. Barreda: We have two uses of [the] exchange stabilization fund right now, Mr. Chairman. One, we use it for activity in the foreign exchange markets where we're exchanging dollars for yen or Deutschmarks or vice versa. We also do it for some short-term bridging. In that case, we make available the dollars in exchange for an assured repayment in hard currency, and we lock in the exchange rate.

Rep. Hamilton: And short-term, in that context, means what?

Mr. Barreda: It's less than six months, according to the statute, unless approved by the President to be longer.

Rep. Hamilton: You have made longer loans than six months, have you not?

Mr. Barreda: I'm not aware of any, sir. I have been discussing with your staff a Mexico loan, and I would like to look into that and get back.

Rep. Hamilton: $600 million for 12 months to Mexico in 1982.

Mr. Barreda: That's the one I want to --

Rep. Hamilton: Are you not aware of that?

Mr. Barreda: I wasn't until now and I'm going to look into it and get back to you.

Rep. Hamilton: Now, of course, you could use this money as a bridging loan to Poland, could you not? That is, you could extend a loan to Poland under the exchange stabilization fund, and then, when the IMF loan kicks in, it could take over the loan. I mean, that's a possibility, isn't it?

Mr. Barreda: If there's an assurance of an IMF agreement and it's short-term, we would certainly consider that, as I said in my testimony. What we want to be sure of is repayment in a hard currency and in short-term --

Rep. Solarz: Will the gentleman yield?

Rep. Hamilton: Mr. Solarz.

Rep. Solarz: Thank you very much, Mr. Chairman. . . .

* * *

Rep. Solarz: . . . . You're saying, I gather, that we cannot -- that if we were to use the exchange stabilization fund without an assured mechanism of repayment that that would be an illegal use of the fund, given the criteria that have been built into it, or would it be a breach of the fiduciary responsibility of the Secretary of the Treasury --

Mr. Kamman: We think it would be an improper use of the fund, Mr. Congressman.

Rep. Solarz: Would it be an illegal use of the fund? Something can be improper without being illegal, and I'm not suggesting that we do something improper, but I just want to know where we stand.

Mr. Barreda: We can try to give you an opinion on that. As --

Rep. Solarz: Can you --

Mr. Barreda: It's an improper use of the fund. We don't think it should be used that way. If there is going to be a chance of loss, we think it should be an appropriation.

Well, in short, I could not agree more. I, too, think the Exchange Stabilization Fund's purpose and past use are quite different from the way it is being used by the Administration in connection with Mexico now. In the past, we have used the Fund for intervention in exchange markets and for very short-term loans, usually bridged to a guaranteed repayment in a hard currency. Providing Exchange Stabilization Fund monies to Mexico on a longer-term basis is a totally different use of the Fund, closer to foreign aid. Moreover, there is a huge risk of loss, exacerbated by the internal banking and financial problems facing Mexico's private lending institutions and businesses. For those reasons, the use of the Fund in this manner without an authorization and appropriation is improper and, again, totally unprecedented.

In the Wall Street Journal on February 1, 1995 there was an article entitled "U.S. Securities Firms and Mutual Funds Have Big Bucks Riding On Mexico Rescue." The article pointed out that U.S. securities firms earned $133 million in annual underwriting fees for Mexican securities, U.S. mutual funds owned $17.1 billion in Latin American assets, and U.S. banks were owed $15.9 billion in loans to Mexico and $41 billion in loans to Latin America. Led by their

desire to cash in on returns of 66% on emerging markets, U.S. financial institutions gambled by pouring "hot money" into Mexico's public sector offerings without fully considering the risks involved. Proper collateralization for private sector loans was the exception rather than the rule. When the peso began to fall, these same U.S. financial institutions saw declines in their share prices of more than a dollar and faced potentially huge losses in the value of their peso-denominated, speculative investments.

It is no coincidence that as of last week, Mexico had already drawn at least $2 billion dollars from the U.S. loans in order to pay $1.3 billion to U.S. banks. Its IMF drawdowns were even greater. The government of Mexico, in fact, owes the world a minimum of $140 billion dollars (some say as much as $200 billion), and about $58 billion of that amount falls due this year, mostly to U.S. financial institutions. Furthermore, Mexico owes U.S. banks alone $18.3 billion this year. As Walker Todd points out in the February 13, 1995 issue of The Nation, "With the peso down in value by forty percent and Mexico's dollar reserves dwindling, it is clear that only a mammoth infusion of funds or forgiveness of its debts can prevent the country from defaulting."

What is interesting to note is that U.S. banks and other financial institutions have balked at helping themselves through this crisis, especially as the federal government became involved. As a recent Wall Street Journal article reported, "Bank executives said the

loan's urgency has been diminished by the $50 billion White House rescue package for Mexico. With a sum that large in the pipeline, they said they might as well take their time considering terms of any new loans they make to Mexico." Most banks will not even consider loaning $200 million dollars to Mexico. Yet Wall Street expects the U.S. taxpayers to shoulder a burden of $20 billion from the U.S. Treasury. And there is no certainty that amount will even begin to cover what is owed.

We have been told that our U.S. Treasury can supply no record of which investors U.S. taxpayers are bailing out. Given that the CIA can help Mexico track down Subcommandante Marcos and a few peasants in Chiapas, as reported by the New York Times, I find it impossible to believe that the Administration does not know who Mexico's creditors are, especially its U.S. creditors. Today, let me give you an idea of who has directly benefitted from the Mexico bailout.

After the announcement of the bailout by the Administration, the performance rating of mutual funds jumped from negative 6 percent to a positive 7 percent. These mutual funds include Scudder, Merrill Lynch, Fidelity, Salomon Brothers and other major Wall Street firms. U.S. banks had an equally large stake in the bailout. Citicorp is owed approximately $2.9 billion by Mexico. Goldman Sachs underwrote no less than $5.7 billion of Mexican securities from 1992 until the crisis. Chase Manhattan, J.P. Morgan and Chemical Banking Corporation are all heavily invested in the Mexican market. U.S.

banks are so eager to get their investments back that they are willing to start a civil war in Mexico if that is what it takes to bring "financial stability." A Chase Manhattan memo blatantly stated that "the [Mexican] government will need to eliminate the Zapatistas to demonstrate their effective control of the national territory and of security policy" and further that "the Zedillo administration will need to consider carefully whether or not to allow opposition victories if fairly won at the ballot box."

In conclusion, I recommend that this Committee pass an authorization bill strictly defining the use of the Exchange Stabilization Fund and narrowly prescribing the authority of the Executive Branch over the Fund, so that it will no longer be able to use the Fund as a form of back door foreign aid. Second, when the use of the Fund goes beyond the strict principles of foreign exchange, an Appropriation by Congress should be required.

Finally, we all know Mexico's problem is not merely a crisis of currency. Mexico has been building a house of debt. Mexico is in the middle of a full-blown social, economic and political crisis. More broadly, Mexico faces manifold challenges which defy simple banking solutions. As Robert Novak observed in his February 20, 1995 column in the Washington Post,

> If all sides in Washington view this as essentially a financial crisis, there is nobody in Mexico City who does. After years of denial by Mexico's rulers and their U.S. counterparts, this country's political system is sick unto death. The well-informed, patriotic Mexicans I saw here

feel the U.S. government has done them no favors by turning its back on continued corruption, the tightened link between drug cartels and the government and the absence of real political dialogue.

Corruption and human rights abuses in Mexico are rampant. Mexico's closed political system has permitted one political party, the PRI, to hold power since the 1920s through fraud, intimidation and outright murder. The questions now being raised in relation to Mexico go to the heart of how the United States responds to a crisis on our southern border -- how we stand up for the best values in us. In order to reach a long-term stabilization plan for Mexico, I also recommend that this Committee authorize the U.S. to initiate and participate in a Hemispheric Commission and appoint a Special Ambassador to this purpose. It should carry as its most basic tenets -- in addition to the long-term stabilization of Mexico -- the creation of a common rule of law, sustainable economic growth policies, and the fostering of multi-party functioning democracies among our trading partners in this hemisphere as conditions of market entry.

After all, free trade can exist only among free people.

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